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Business this week

Sep 27th 2001
From The Economist print edition

The federal government agreed an aid package for **America's airlines** to protect them from the aftermath of the terrorist attacks on America which left cabins nearly empty. The airlines, most of which were in trouble before September 11th, were promised grants and loans totalling $15 billion, to be distributed by size rather than long-term health.

See article: A business in search of customers

Governments worldwide agreed to cover national airlines after insurers limited liabilities on **third-party damage** for similar terrorist incidents to $50m per aircraft. Many airlines said that they could not afford to fly unless governments intervened.

Airlines responded to falling business by cutting staff and services. America's **Delta Air Lines** cut its workforce by 13,000, some 16% of the total, and reduced schedules by 15%. Italy's **Alitalia** announced that it would lay off 17% of its workforce and ground some planes. **Air Canada** said it would shed 5,000 staff and cut 20% of its schedule. **KLM Royal Dutch** introduced a surcharge on ticket prices and increased prices on fares to the Middle East.

America's insurance industry, also hard hit, is likely to get help against the risk of future terrorist incidents. Lawmakers are considering legislation that would make the government the insurer of last resort in the event of further assaults.

See article: Risk's new dimension

Lloyd's of London, the insurance market, estimated that its net share of the insurance bill for the attacks would be £1.3 billion ($1.9 billion). This would be Lloyd's biggest-ever single loss.

Profits at big **investment banks** are on the wane. Lehman Brothers said its profits were down by 32% in the past quarter compared with a year ago. Goldman Sachs reported a decline of 43%, Bear Stearns one of 26% and Morgan Stanley one of 41%.

On the wane

America's economy appeared to be foundering. The Conference Board's measure of consumer confidence—only partly accounting for feelings after the terrorist attacks—fell sharply in September. Car makers said that they expected sales, an informal leading indicator, to fall by up to 20% in September compared with a year earlier.

See article: Cheap, but not cheerful

The IMF predicted further gloom for the **world economy**. In its *World Economic Outlook* it forecast global growth of 2.6% this year, down from a previous estimate of 3.2% six months ago. But this forecast was not updated to take account of the terrorist attacks on America. The IMF's chief economist, Kenneth Rogoff, suggested that a recession in America was a “done deal”, though he later withdrew the remark.

See article: Going downhill

European Union leaders decided that **budget deficits** should be allowed to rise above pre-agreed limits

this year to cushion member countries as the world economy worsens. The European Central Bank said that this was within the terms of the “stability pact”, which is meant to penalise member countries that allow deficits to rise above 3% of GDP.

GE force

Jeffrey Immelt, who succeeded Jack Welch as chief executive of **General Electric** in early September, forecast that profits this year and next would rise by 10% or more despite the terrorist attacks and the struggling world economy. He claimed that GE was “built to outperform” but noted that a large-scale war could harm the company's prospects.

Kvaerner, a heavily indebted Anglo-Norwegian engineering company, teetered on the brink of bankruptcy. Banks agreed to extend short-term loans but the company's plans to raise some NKr2 billion ($230m) with a rights issue were met with little enthusiasm by investors. The company's shares lost 80% of their value over the past week.

EMI revealed that pre-tax profits for 2001 would be down by around 20% compared with the year before; its shares responded by plummeting 35% in one day. The British music group, which failed to clear regulatory hurdles in merger attempts with both Bertelsmann and AOL Time Warner, looks an invitingly cheap target for a takeover.

Advanced Micro Devices, the world's second-largest chip maker, announced that it would cut 2,300 jobs, some 15% of the total, after Gateway, a big PC maker, phases out its line using AMD's chips.

Procter & Gamble, the world's leading consumer-goods company, abandoned a health-drink and snack joint-venture with Coca-Cola, the world's biggest soft-drink firm. After reconsidering the much-heralded deal, claimed as a trailblazer for the future of global distribution and marketing, the two firms decided to pursue separate strategies.

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Fighting terrorism

Closing in

Sep 27th 2001
From The Economist print edition

So far, so good. But there is a long way to go

IN THE two weeks since September 11th, there has been a lot to surprise the many quasi-professional denigrators of America who lurk abroad, especially on the West European left. The United States did not immediately lash out in a vengeful rage. President George Bush did not fall on his face or reach for his gun; instead he has shown considerable amounts of skill, subtlety, leadership and, above all, intelligence. Countries in the Middle East and Central Asia, in the midst of which sit the al-Qaeda terror bosses and their Taliban hosts in Afghanistan, did not rush to gang up on America; instead almost all offered some degree of support, forming a fragile but nevertheless remarkable coalition. All of this will have surprised not only the anti-American pundits but also a rather more important group, the anti-American terrorists themselves. The campaign against them has got off to a very good start.

But it is only a start. The campaign already has many dimensions: co-ordination of financial controls, an international police investigation, diplomatic pressure, careful reassurance of Muslims both within America and elsewhere, the encouragement of new peace talks between Israel and the Palestinians, the encirclement of Afghanistan with allies and with military forces. Yet the next stage will also be the trickiest: the beginning of military action inside Afghanistan. Everyone, not least the Americans, has been at pains to stress that this action will be only one part of the effort, and that it will not involve a massive, spectacular landing such as on D-day in 1944 or a huge bombing raid. Even so, the conduct of that action—and its success or failure—will have an immense effect on all the other dimensions of the campaign.

Remember Sarajevo

It is easy to outline the risks. They begin with the dilemma surrounding the very aim of the military action. On September 20th, in his stirring speech to Congress, President Bush suggested that there would be two targets: al-Qaeda, with its boss Osama bin Laden; and the Taliban regime itself. Since then, Mr Bush's officials have been retreating from that language, seeking to focus solely on al-Qaeda (see article). This may well reflect worries among America's front-line allies, notably Pakistan, but also perhaps some Arab countries, that a broader aim could invite retribution by the Taliban against them, and that more Afghan refugees might soon be heading their way. In fact, it is hard to see how the terrorist infrastructure in Afghanistan can be destroyed without also bringing down the Taliban, so both aims may be necessary. But then the risk is that Afghanistan will be left with no government at all, and could become even more unstable and troublesome.

The worries move on to instability elsewhere. Clumsy military action could recruit more Pakistanis to the terrorists' cause, and they might overthrow their own government if they can find support within the country's military and religious establishments. Saudi Arabia is not the only Arab state at risk, but it is the most important—because of its wealth, its holy sites and the weakness of the dynasty that rules it. Most probably, al-Qaeda's greatest hope would be the overthrow of the Saudi ruling family by factions that were not only fundamentalist (as the House of Saud already is) but would also eject America's military bases from Saudi land (see article). That danger explains why the Saudi government has given America such ambiguous support: it has backed its efforts diplomatically and has broken off relations with the Taliban, but has also refused to allow the American bases to be used for the military effort in

Afghanistan.

The risks can be summed up by historical analogy. Since September 11th, there has been much reference to the appeasement of Hitler in Munich in 1938. In Munich, as Churchill put it, the appeasers had a choice between war and dishonour, and chose dishonour; but that meant only that there would also eventually be war. This is the case for fighting the terrorists, rather than meekly asking them for their demands and waiting for the next outrage. But there is also the analogy of Sarajevo in 1914, when a terrorist's assassination of the heir to the Austro-Hungarian throne led to a chain of events culminating in the first world war. America's task is to avoid such a chain. The terrorists' hope will be to bring it about, probably through further provocations and atrocities.

Opportunity out of unity

The dangers are great. But that was clear the moment the attacks on New York and Washington took place, as was the fact that not to act against the terrorists would be more dangerous still. What is striking now, a fortnight later, is that there are also opportunities. And those opportunities, hard though they may be to realise, are also great.

The coalition that America has assembled is extraordinary. An alliance that includes Russia, the NATO countries, Uzbekistan, Tajikistan, Pakistan, Saudi Arabia and other Gulf states as well as acquiescence from China and Iran would not have been imaginable on September 10th. It reflects a combination of things: horror at the sudden slaughter of more than 6,500 people; enmity towards Afghanistan; self-interest in gaining western support against domestic rebels; an acknowledgment of America's military and economic importance.

Such an alliance, as well as being fragile in the face of military action, poses dilemmas. Rather as during the cold war against Soviet communism, as soon as foreign policy comes to be seen solely through the prism of a single fight, in this case against terrorism, so other considerations, such as democracy and human rights, become forgotten. Friendship with Iran, China or indeed Pakistan involves friendship with dictators, who are often brutal.

So long as this fight is conducted with deliberation and resolution, however, it ought not to be as long and all-consuming a fight as that against communism, so those other considerations need not be shelved in the same way. Permanent obligations need not be incurred. Meanwhile, the chance of exploiting the alliance and its associated alignment of interests to make progress on some of the world's most intractable disputes is real.

On top of the list come Israel and Palestine, and Kashmir. Pressure from America, along with a heightened sense of vulnerability on both sides, could push the Israeli and Palestinian leaderships to resume serious peace talks (see article). Neither side shows signs of relishing the thought, but the possibility is there. As for Kashmir, India is acutely conscious of the American backing that Pakistan's government may in future enjoy, both as a result of its immediate support but also amid a common effort to stabilise the region if the Taliban are indeed defeated. At that point the role of Pakistan's own Islamic militants, who are active in Kashmir, could recede, making peace easier to contemplate.

And then there are the small matters of Russia and China, great powers with which America has had a scratchy relationship of late. At least with Russia, the prospects of smoother times, along with a recognition of the two countries' mutual interests in improving security and containing nuclear proliferation, now look good. The risks may be great. But there are great prizes to reach for too.

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Government reaction

Liberty v security

Sep 27th 2001
From The Economist print edition

The current emergency justifies a shifting of the balance—but under clear democratic controls

GEORGE BUSH correctly called the attack on America “an attack on freedom”. It was also, to some extent, an “attack through freedom.” The terrorists were able to strike at the world's most open society partly by exploiting its openness. Now, as western governments rush to block these loopholes, many fear that they will inadvertently finish what the terrorists began—and curtail the very freedoms which they are fighting to protect.

In America, Mr Bush, who came to power hoping to reduce the reach of government, is overseeing an increase in its powers (see article). Some of that is planned through new programmes and activities, but some has reflected immediate action by the FBI and police: more than 350 people have already been arrested under emergency rules. In Britain, the debate about introducing national identity cards has gained new vigour (see article). In many countries, leaders are looking at tougher “anti-terrorism” laws ranging from surveillance and powers of arrest to financial disclosure and racial profiling. As one headline has it, “thousands dead, millions deprived of civil liberties.” Politicians acidly reply that theoretical liberties were not of much use to the dead in the World Trade Centre.

Amid all this sound and fury, both sides need to consider the fundamental question: in light of the attack, where must the balancing point between security and liberty be set? Civil libertarians should begin by admitting that, contrary to much of their rhetoric, some sort of a balance has always had to be struck. Even fundamental freedoms—for instance, that of speech—are not absolute. People who shout fire in a crowded theatre can expect to be arrested. Defence is the area in which freedoms are most often restricted. Most democracies already grant some discretion to their policemen over whom they investigate, and offer broad protections for secrecy. Many require their citizens to carry identity cards.

Next, libertarians need to accept that, from a security point of view, September 11th was genuinely a day when the world changed. To be sure, that change was most dramatic in America, a country which has had relatively few terrorist attacks of any sort. But even for western countries that have been exposed to bombs and bullets for longer, the bombings of the World Trade Centre and the Pentagon unveiled a new level of threat. The scale of the outrage (the death toll was ten times larger than any comparable tragedy), the use of suicide bombers, the lack of warning, the conversion of aircraft into flying missiles, all should serve as prompts to re-examine old procedures and question established liberties—be they “the freedom” to carry and buy knives at airports or “the freedom” to stash your money in a numbered account in Liechtenstein.

However, if libertarians must accept that something changed on September 11th, authoritarians need to accept that not everything did. Many of the failures of security were not connected to unrestrained liberty, and some measures currently being floated are only tangentially linked to the disaster. Most Britons would not worry too much about carrying identity cards, since they already carry many bits of plastic that serve to identify them; the main objection would be to being charged with a crime, or held on suspicion, simply if they have left their card at home. Nevertheless, supporters of identity cards have overlooked the fact that the hijackers did produce identity papers of one sort or another at the airport. Several were travelling under stolen passports. Identity theft is a growing crime in America—and presumably would be even worse in Britain, where records are appalling.

On the whole, the security lapses in America had less to do with liberty than inefficiency. Security was found wanting, partly because it had to deal with what once seemed an unimaginable threat and partly because, on the evidence available, it did not work well. In particular, America's lavishly-funded

intelligence services failed to spot that dozens of cohorts of the country's “public enemy number one” had entered the United States, were taking flying lessons and loitering around airports. Much of the failure can be ascribed to an old-fashioned lack of informants and poor collation of existing information, though restrictive laws on wiretapping and other surveillance methods cannot have helped.

The emergency v the longer term

The most important distinction that will need to be drawn is between those measures that are necessary because of a current emergency and those that are desirable for the longer term. With military action likely to prompt further atrocities from terrorist groups, the case for greater emergency powers of surveillance and arrest is strong in any country in which retaliation could occur. Such powers should, however, be granted only with sunset clauses attached so that they need to be reconsidered in a democratic forum before they can be reinstated. Such powers should also remain subject to case-by-case judicial approval—when practical, in advance, but if necessary, in retrospect—in order both to avoid their misuse and to maintain public confidence.

The longer term will pose tougher issues, for even then the security will be needed not against a visible enemy such as another country but against an invisible, potential enemy which September 11th showed could come from many quarters. Efficient security, whether at airports or in any other public place, is itself a challenge to liberty for it steals away time, involves intrusive searches, and restricts freedoms of movement and behaviour. The likelihood must be that, as long as it is done in a way that is non-discriminatory and subject to legal controls, people in democratic countries will choose to accept such security in their own interests. But as this campaign proceeds and as the debate develops, they will have to be given that choice, either directly or through their elected representatives. Democracy is, after all, another of the values that the terrorists have sought to challenge.

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The hubris of the West

Is globalisation doomed?

Sep 27th 2001
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According to its critics, globalisation has a lot to answer for

IN CHOOSING the World Trade Centre for their principal target, the terrorists were striving not merely to kill as many Americans as they could, but also to tear down a potent symbol of America's economic might, of its ideas and values, of capitalism. If the shock of the attacks and the war on terrorism that is just beginning do lead to global recession, as many fear, the West's faith in market economics may indeed be tested. If this happens, will it be right to see it as merely a brief swerve in sentiment, as one would expect in any severe economic slowdown? Or does the terrorist "backlash" against the ideology of America and the West, if that is what it was, demand a deeper response—a reappraisal, even, of that very ideology?

Some in the West are arguing that it does. John Gray, a professor at the London School of Economics and a much-quoted thinker on these matters, spoke for many last week when he declared that the era of globalisation is over. "The entire view of the world that supported the markets' faith in globalisation has melted down...Led by the United States, the world's richest states have acted on the assumption that people everywhere want to live as they do. As a result, they failed to recognise the deadly mixture of emotions—cultural resentment, the sense of injustice and a genuine rejection of western modernity—that lies behind the attacks on New York and Washington...The ideal of a universal civilisation is a recipe for unending conflict, and it is time it was given up."

Wicked and dangerous

Is there no limit to the crimes for which globalisation must be held to account? Not only does it oppress the consumers of the rich West, undermine the welfare state, emasculate democracy, despoil the environment, and entrench poverty in the third world; we knew all that already. In addition, we now find, it is a utopian scheme for global ideological conquest—like Stalinism, minus the compassion. Truly, the idea that people should be left free to trade with each other in peace must be the most wicked and dangerous doctrine ever devised.

Either that, or a lot of people are talking nonsense. In fact, this is a distinct possibility. Western governments do a poor job of explaining and defending globalisation—so poor as to breed disaffection with democratic politics. This does not alter the fact that the substantive charges of the anti-globalists fail to stand up. This week, we publish a survey reviewing their arguments. We had intended it to coincide with the annual meetings of the IMF and the World Bank, scheduled for this weekend but cancelled after the attacks; the article was written (for the most part) before September 11th, but in view of the links that are being drawn between the perils of globalisation and anti-western rage, we believe it remains relevant. Globalisation undermines neither the welfare state nor democracy, our survey argues; it is entirely consistent with sound environmental policies (see article); above all, far from increasing poverty in the third world, it is the most effective force for reducing poverty known to mankind.

But what about the view that globalisation is a kind of cultural conquest? This too is plainly wrong. Under a market system, economic interaction is voluntary. This is the market's greatest virtue, greater by far than its superior productivity. So there is no reason to fear that globalisation itself threatens traditional non-western cultures, such as Islam, except in so far as individual freedom threatens them. McDonald's does not march people into its outlets at the point of a gun. Nike does not require people to wear its

trainers on pain of imprisonment. If people buy those things, it is because they choose to, not because globalisation is forcing them to.

In some countries, governments may see globalisation as a threat to their power as tyrants. They probably overstate the danger, but in any case we leave Mr Gray to speak for them. Where governments reflect the preferences and beliefs of most citizens, democratically or otherwise, and where those preferences call for cultural distinctness and non-western values, economic integration does not militate against diversity, least of all against religious diversity. In the West, globalisation has been running at full power for years. Has it mashed the United States, France, Italy, Germany, Sweden and Japan into a homogeneous cultural putty? It has not, and there is no reason why it ever should.

This is not to say that the future of globalisation is assured. Far from it. Economic liberty suffered a terrible reverse in the 1930s, thanks to war, financial breakdown and bad government. That brought one era of globalisation to an end, and history could repeat itself. Let us at least agree, however, that if governments allow this to happen it would be a tragedy—and not for the rich West, first and foremost, but for all the poor of the developing world.

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Letters

Sep 27th 2001
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The battle against terror

SIR – Those who hate America do so specifically because "it has brought more wealth and better living standards to more people than any other [nation] in history" ("The roots of hatred", September 22nd). America is the ultimate refinement of a "western" culture of business, law, equality, freedom, education and secularism that continues to outperform its competition, whether it be communism, fascism or Islamic fundamentalism. The losers in such a cultural competition console themselves by claiming moral superiority, the real roots of hatred.

Osama bin Laden blames America for corrupting his Saudi homeland by paying for and defending its oil; the alternative is to admit the socioeconomic inadequacy and moral bankruptcy of his patrimony. The Taliban blame America for destroying Afghanistan; the alternative is to admit that feuding Islamic factions managed the extraordinary feat of replacing communism with something even more dysfunctional.

Gerald Loeb
Los Angeles

SIR – You grossly underestimate the strength of feeling generated in the Arab and Islamic worlds by the uncritical and unconditional support given by America to Israel in her oppression of the Palestinians. America is viewed as the pillars upon which the tormentors of the Palestinians depend. Its interventions are seen as biased and aimed at helping to procure peace for Israel on Israel's terms.

There seems an unwillingness to recognise that when people are cornered, humiliated and crushed, and have no hope of escaping, some of them at least will no longer be afraid to die or care about which of their perceived enemies they take with them. A sophisticated war machine cannot eradicate them. Such people are unstoppable.

Samir Shakir
London

SIR – You are right that resentment, however deeply felt, cannot justify or excuse the attack on America ("The battle ahead", September 22nd). It is also right to call for an appropriate, well-thought out retaliation. However, you do not consider the issue which many would hold important in "solving" the problems of terrorism: resentment. Many people, rightly or wrongly, feel let down by the rest of the world, and until this is addressed, we can only expect more terrorism.

Atsuko Ichijo
London

SIR – Every war strategy ever devised is based on a basic assumption—people do not want to die. This assumption does not hold when one is faced with a terrorist who is not afraid to die. Bombing Afghanistan, or any other country, will turn normal people into valuable new recruits to terrorism. All terrorist movements use violence as a strategy for they know that retaliation will bring new members into their fold. It is a win-win situation for them. America should not walk into this trap. This is the time for cool temperament and wise heads. One who plans revenge digs two graves.

S. Shivasabesan
Canberra

SIR – The lack of security at airports was a deliberate decision of the airline industry to underinvest in safety ("Uncharted airspace", September 22nd). Since the industry did not think their aircraft were worth protecting, the airlines should not be surprised at the losses. Terrorism is hardly a new phenomenon. The airlines and their insurers profited from this underinvestment and it is only right that they should share in the losses from this business decision. Protecting firms from their own folly (the socialisation of losses, if you will) only fosters an atmosphere where companies take bigger risks if they can pass losses to taxpayers. This was the lesson behind the savings-and-loan scandal, Crédit Lyonnais, and the entire financial industry in Japan. The Bush administration should not bail out airlines; it should hand them the bill.

Joe Donohue
Groton, Connecticut

Museum piece

SIR –*The Economist* diminishes itself by publishing such a superficial, sneering and ill-informed article about the British Museum ("Museum pieces", September 15th). Contrary to what you infer, the museum has just completed a decade of unparalleled renewal. Curatorial standards (ignored by you) remain as high as ever, and there is no substance in the innuendo that it is falling behind the standards of European or American counterparts.

The recently opened Great Court involves far more than the renovation of the Reading Room. Over £100m ($145m) was raised by the trustees from lottery funds and private donors to make a reality of Norman Foster's imaginative concept of a public space in the centre of London. The historic Reading Room, surrounded by additional facilities for the public, is preserved and refurbished, and now stands as a focal point of the new Great Court. All the resources of modern technology are utilised to make the extensive collections more accessible to visitors and scholars alike.

The belittling reference to the distinguished director and the undeserved personal criticisms of the present and incoming chairman of the trustees are particularly regrettable. As a former long-serving trustee, with the honour of chairing the board for ten years, I can vouch from personal experience the dedication and professionalism of those appointed by the prime minister to serve as trustees, or elected by the existing board members.

Newer and more interventionist departments of government may be irked by the greater independence of the British Museum—protected by statute—than other national museums and galleries. At a time when its public funding has been reduced by 30% over the past decade, there can be no denying the magnitude of the recent improvements, supplemented by many valuable acquisitions, while maintaining the principle of free public access.

Lord Windlesham
Oxford

Branded business

SIR – You fail to highlight a growing predicament among lower- and middle-class families; coming to terms with a generation that thrives on branded products while struggling to make ends meet ("The case for brands", September 8th). Parents are forced to accede to children's demands because of peer pressure at school and outside. For example, the number of times football clubs like Manchester United change their strips. How many parents can afford to buy one every season? Not many, yet somehow most of them manage.

Purchasing a brand serves as a guarantee for the consumer of quality and service. Unfortunately, for many, it also means hardship. Naomi Klein's theory borders on the extreme but there still is a hint of truth in what she says.

David Kelleher
St Julian's, Malta

SIR – You assert that the attack on brands is counter-productive because brands are “highly effective tools through which to bring about change.” Let me get this straight: anti-branding activists are misguided in trying to change corporations by attacking their brands because brands allow them to bring about change?

Ted Rutland
Toronto

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About sponsorship

Fighting terrorism

Having second thoughts?

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AP

America has a strange enemy to confront and a motley coalition to manage. It is struggling to define its strategy

ON THE ground, the week that began with American warplanes roaring towards Afghanistan had a tentative, almost muted quality. The Taliban claimed to have shot down an unmanned American spy plane. There were unconfirmed reports that four of Britain's Special Air Service (SAS) commandos had been shot at near Kabul. Otherwise, an anxious calm prevailed.

Protracted and meticulous military preparations, so different from the all-out assault some had expected by now, had their counterpart in diplomatic and political developments in Washington. America and its allies seemed to slow, perhaps only briefly, their momentum towards full-scale military engagement. And the goals of the operation itself were refined—perhaps more than merely refined—to the consternation of some and the relief of many.

In his speech to Congress on September 20th, President Bush had seemed clear enough. “Our war on terror begins with al-Qaeda but will not end until every terrorist group of global reach has been found, stopped and defeated.” That left open the question of which groups exactly he deemed to have “global reach” (does Hamas qualify?) but was otherwise definite about the aim. Mr Bush was also explicit both about the military nature of the response (telling soldiers, “be ready, the hour is coming”) and about the responsibility of the Taliban (“by aiding and abetting murder, the Taliban regime is committing murder”).

Considering his earlier ultimatum to them to turn over Osama bin Laden, and given that ships and aircraft were heading towards the region even as he spoke, Mr Bush's speech seemed to imply that the overthrow of the Afghan government was an American war aim, and that the assault to achieve it was about to begin. Three days later, however, Colin Powell, the secretary of state, sounded far less bellicose. “Let's not assume there will be a large-scale war,” he said. And he drew a distinction between al-Qaeda and its protectors. “I'm not going to say that it has become one of the objectives of the United States government to either remove or put in place a different regime.” Conservatives accused Mr Powell of being unwilling to fight, and argued that he was seeking to reverse the president's decision to remove the Taliban by force.

They also noted that the president had forced Mr Powell to modify his earlier promise to make public some of the evidence linking Mr bin Laden to the terrorist attacks. This was a clear example of the conflict between America's need to make a case to the world and its need to protect its intelligence sources. The demands of international persuasion were the loser, though the deputy secretary of defence, Paul Wolfowitz, did offer a little evidence to a meeting of defence ministers at NATO headquarters on September 26th.

These flurries constituted the first serious round of domestic criticism since September 11th. They raised the possibility that the differences of emphasis between Mr Bush and Mr Powell reflected wider uncertainty within the administration about how to proceed. Yet Mr Powell and Donald Rumsfeld, the secretary of defence, now seem in closer agreement than they did before. Mr Rumsfeld's tougher-sounding views had earlier sounded at odds with the secretary of state's. Lately, Mr Rumsfeld has also been lowering expectations of a sudden large-scale military operation, saying that there will be no D-day. He also argued that America should try to divide the Afghan government, rather than overthrow it by invasion: “There are many in the Taliban who prefer that the Taliban not harbour Osama bin Laden and the al-Qaeda network.”

And the president himself has echoed this view. “One way to [smoke out Mr bin Laden] is to ask for the co-operation of citizens within Afghanistan who may be tired of having the Taliban in place, or tired of having Osama bin Laden.” Ask for co-operation? Hardly the words of a warmonger. And this was not a Bushism. Ari Fleischer, the president's spokesman, spelled out the implication: “[America's policy] is not designed to replace one regime with another regime.”

Everyone including Mr Powell continues to talk about military action. Everyone accepts that at least part of the Taliban must be a target. Such ambiguities as remain are probably deliberate—a feint to distract the Taliban from its preparations. If there are genuine and fundamental disagreements as well, they are sure to cause difficulties in the near future. For the moment, though, the administration seems more united than it has been for months. And the upshot, apparently, is that it has decided to row back somewhat from immediate, full-scale war.

More united than ever, the administration has pulled back somewhat from immediate, full-scale war

Why? One reason is that America's calculations about divisions within Afghanistan have changed. True, Mullah Muhammad Omar, the head of the Taliban, rejected Mr Bush's ultimatum of September 20th, and summoned Afghans to a holy war if America attacked the country. Yet the council of Muslim clerics (who elected him their leader) had earlier responded to American demands to hand over Mr bin Laden by suggesting he “volunteer” to leave the country. Mr Bush naturally rejected this as inadequate—but, by Afghan lights, it was a concession. It suggested the possibility of exploitable differences of opinion among the Taliban.

At the same time, American planners seem to be reconsidering the usefulness of the main Afghan opposition, the Northern Alliance. The assassination of their military commander, Ahmad Shah Masoud, two days before the attacks on America had seemed a serious blow. In any case, the alliance has only around 10,000 soldiers, compared with the Taliban's 40,000. But in the past week, the alliance has shown signs of life. Its troops claimed to have taken villages in three provinces in the government-held north of the country, near the border with Uzbekistan and Tajikistan—close to where American planes and soldiers are, or may soon be, stationed. (The Taliban quickly claimed to have seized them back again.) The alliance also said that a Taliban commander, Abdul Samad, had defected along with his men in the same region.

The Northern Alliance is unlikely to produce a stable alternative to the Taliban government. It is fractious, and dominated by Uzbeks and Tajiks, minorities that would not command the support of the dominant Pashtuns. For that reason, American officials have held talks in Rome with the exiled king of Afghanistan (a Pashtun) and with opposition groups from another tribe, Hazaras. For the moment, though, it still makes sense to arm and support the Northern Alliance. Vladimir Putin, with American backing, has offered to give them Russian arms.

There is another, and possibly more important, explanation for the administration's change in policy. America seems to be narrowing its aims in order to keep its extraordinary collection of allies on side, one way or another.

On the face of it, the building of this alliance has been a stunning success. As a result, Afghanistan has been almost completely isolated diplomatically. On September 22nd the United Arab Emirates cut off ties. Saudi Arabia did the same three days later. That left Pakistan as the only country still maintaining formal relations with the Taliban—and it has pulled its diplomats out of Kabul.

Russia's actions have been just as remarkable. Although Mr Putin ruled out military co-operation and said he would allow Russian bases to be used only for “humanitarian” operations, he lifted his objections to American military use of bases in Tajikistan and

Reuters

Uzbekistan, where Russia retains influence and arms. This is the first time America has been offered the use of bases in the former Soviet Union. In apparent thanks, the Bush administration on September 26th strongly backed Mr Putin's challenge to the Chechens to cut their ties to terrorist groups within 72 hours.

Our faithful friends, Vladimir and Gerhard

All this looks impressive. Yet it still makes sense to talk not of one alliance, but two: the “front-line coalition” of states that surround Afghanistan, and the wider group of countries threatened by international terrorism. This latter group is strong, but militarily unnecessary. The front-line states are vital militarily, but not so strong.

Public support for the alliance in Europe, Japan and beyond remains firm, perhaps buoyed by the apparent retreat from the prospect of mass attacks. These countries play roles in diplomacy, in hunting down the finances of the al-Qaeda network and in arresting suspected terrorists on their lands. Britain's foreign minister, Jack Straw, travelled to Iran to sound out its government for support—something America could not have done. The German central-bank chief launched an investigation into shorting operations on European exchanges that may have been used by al-Qaeda to cash in on its attacks of September 11th. Several dozen suspected terrorists have been arrested in France, Germany and Britain.

The wider alliance also plays a role economically. So far, the American Senate has approved a free-trade agreement with Jordan. America has rescheduled some of its $3 billion in bilateral loans to Pakistan, lifted some sanctions on India and Pakistan and extended special trade preferences to Indonesia. Other countries may benefit in the same way.

A wider alliance is useful economically and diplomatically, if not necessarily militarily

But, except possibly for Britain, members of the wider alliance will not play a significant military role. Chancellor Gerhard Schröder of Germany, for example, has talked about offering troops. But to do so risks fracturing his coalition government: many members of the Green Party, his junior partner, are adamantly opposed to a war. One ambassador to NATO says privately that America does not want NATO's help, partly because of security doubts, partly for operational reasons.

The real military and intelligence help must therefore come from Afghanistan's neighbours, and they are the very ones most worried by the prospect of destabilisation at the hands of the Taliban or sympathisers of Mr bin Laden within their own borders. Pakistan has so far faced down its protesters more successfully than expected. But the responses of others have been equivocal. Saudi Arabia has done everything America has actually asked it to, says Mr Powell. But there is still doubt whether America will be allowed to use the Sultan air base outside Riyadh. Iran received Mr Straw but would be much happier if the United Nations, not America, led any operation.

The consequence must be that America will fight, as it has said, a war on many fronts. It can rely on its broad alliance for its diplomatic, financial and policing aims. But when it comes to military operations, it must rely largely on itself and on the shaky alliance in the region—which means, for the moment, aiming narrowly at the fugitive figure of Mr bin Laden himself, and his shadowy organisation.

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About sponsorship

The shape of battle

An alliance of old and new

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AP

America and its allies will be using sophisticated new weapons, but they still need old-fashioned sweat and blood

IT MAY be remembered as the most low-tech, and the most high-tech, campaign in military history. The war that America and its allies are preparing to wage will draw heavily on new developments in precision guidance, surveillance and communication—but it will also depend on the old-fashioned arts of stealth, survival and surprise that are cultivated by tiny units of crack troops.

The Global Hawk, an unmanned eye-in-the-sky which flies at very high altitudes, will certainly come into play; but so too will “the human eyeball, mark one”, as British special forces call their most effective reconnaissance tool. Once a handful of nimble-footed scouts are in place, they can act as forward air-traffic controllers to guide bombers to their targets. To succeed, however, this technique requires a finely tuned mixture of electronics and human grit. The combination is dictated by the extraordinary terrain of Afghanistan, which is easy to hide in and almost impossible to occupy; and by the elusiveness of the Taliban regime, which may not easily be intimidated by threats to flatten Kabul.

At the same time, the ships, aircraft and submarines that America and Britain have deployed in the Gulf and the Indian Ocean seem to represent more firepower than would be needed to attack Afghanistan alone. This has led to speculation that the American-led effort will quickly switch its attention to other countries—and may even turn into the all-out attack on Iraq that some in Washington favour.

The methods that were employed in the past decade's air wars against Serbia and Iraq—using precision-guided, long-range weapons to attack vital military, political and economic assets—seem ill-suited to warfare against the Afghan regime, in part because there are few obvious targets. In the words of Andrew Krepinevich, an American military theorist, “This is an enemy whose centres of gravity are hard to find. You could destroy some bridges and wreck whatever power supplies exist, but that might seem to the world like an attack on Muslim civilians.”

Modern “air war” principles could of course be reapplied, with added toughness, against Iraq. In the words of Stratfor, a Texas-based consultancy on world affairs, “Iraq...is very convenient for an air attack. Such an attack would have the added benefit of striking at someone who, in the long run, is much more dangerous to American interests than are the Afghans.”

Whatever the long-term “benefits” of such an approach, it would probably alienate many of the allies America has assembled. It does not seem to feature in the administration's current plans. But, as Mr Krepinevich says, “No war plan ever survives contact with the enemy—once war breaks out, it has a dynamic of its own.”

Paul Beaver, a defence consultant, predicts that the American-led military effort will focus first on inflicting punishment on the Taliban regime, including the destruction by air of its crude armoury of Russian-made tanks and aircraft. The next aim would be to destroy the terrorist training network established in Afghanistan by Osama bin Laden. Concurrently or soon afterwards, attacks could come on targets in other countries—possibly including Iraq, Sudan and Somalia—that are associated with the terrorist network.

Destination Afghanistan?

United States

***USS Enterprise* (aircraft carrier)**

-supported by 10 ships, 2 submarines and 3 amphibious units

-maximum of 85 aircraft and 8,000 personnel

***USS Carl Vinson* (aircraft carrier)**

-supported by 9 ships, 2 submarines and 3 amphibious units

-maximum of 90 aircraft and 6,000 personnel

***USS Theodore Roosevelt* (aircraft carrier)**

-supported by 8 ships, 2 submarines and 3 amphibious units

-maximum of 85 aircraft and 5,500 personnel

Over 100 aircraft at bases in region

Amphibious squadron with 3,000 personnel

The current deployment suggests that America's war aims do not include over-running or occupying Iraq. In contrast to the build-up before the 1991 Gulf war, there has been no significant movement of the American and British armies' heavy divisions. To the extent that ground forces are used, they are likely to be much smaller groups of crack troops.

To understand the difficulties of winning a fight in Afghanistan, say veterans of the anti-Soviet war of the 1980s, it is necessary to travel only a few miles south of Kabul to the cliffs of Sorobi, a rebel stronghold. Whenever they felt safe, the fighters would perch defiantly on narrow ledges running down the cliffside; at the first sight or sound of a Soviet helicopter, they would hunker down in caves that extended for hundreds of yards into the heart of the mountains. Nothing could dislodge them except hand-to-hand fighting—or blowing up half the mountain.

In Afghanistan's terrain of towering peaks and deep valleys, where it can take a week to walk a

distance—as the crow flies—of 25km (15 miles), any military operation must rely heavily on local allies who know where to find water, food and shelter. In a few weeks' time, snow will start falling, often in blizzards that make helicopter flights impossible. “The only sort of military unit that makes sense for a foreign army is the four-man team which is primed to perform one task and then get out quickly,” says Richard Cleghorn-Brown, a communications expert who in the 1980s worked with the Afghan mujahideen fighting the Russians.

Burden of technology

Although the Pentagon has dreamed up many kinds of “smart” gadgets that would turn foot-soldiers into walking computers, most of this kit is still on the drawing-board—or, if it exists, is too heavy to lug around the Afghan mountains. In their fight with Russia, the rebels found that simple weapons worked fine. These included bazookas or rocket-propelled grenades which western armies would consider obsolete. American Stinger missiles, shoulder-held devices designed to shoot down helicopters, are often credited with forcing the Soviet Union to withdraw. A European equivalent—MILAN wire-guided missiles—also proved effective.

Now this chopper-killing prowess could be turned against the very British and American forces that helped to impart those skills. The Taliban's forces will certainly include veterans of the western-backed campaign against Russia. And although the best western helicopters are equipped with more firepower and detection devices than ever, their whirring blades can still be stopped by a low-tech attacker prepared to risk his own life.

Simple weapons worked fine against Soviet helicopters. They can stop American ones, too

All this puts a premium on special forces. Their skills include the ability to make freefall parachute drops and quick escapes—infiltration and exfiltration—in appalling conditions, as well as the know-how needed to create hideouts and stay in them for weeks at a time, living off the land. Special forces include linguists and specialists in “civil affairs” and psychological warfare, with the job of winning over local hearts and minds.

Special forces are at a premium

Most of America's special forces—drawn from the army, navy and air force—are co-ordinated by a the Special Operations Command. These super-soldiers include the army's Green Berets, whose basic unit is the 12-person A-team, designed as a power-house of expertise in explosives, communications, engineering and linguistics. A sort of elite within the elite is the Delta Force, set up by an American officer who served with Britain's Special Air Service (SAS) and copied its model of four-man teams. The Delta Force has recently been used to track Balkan war-crimes suspects.

The army's Rangers, a crack force whose history predates American independence, could be used for strike missions behind enemy lines. Its skills range from urban warfare to capturing villages. Lightning reconnaissance might also be carried out by the navy's Seal units or the “expeditionary units” of the marines—though military insiders predict that their skills may come into play in theatres other than Afghanistan.

Britain's SAS, which has seen service recently in Northern Ireland, the Balkans and Sierra Leone, has the advantage of a long-standing relationship with the leaders of the Northern Alliance of Afghan forces opposed to the Taliban. Ahmad Shah Masoud, the recently assassinated commander of the alliance, and warrior-in-chief of Afghanistan's Tajik community, was considered a British protégé during the anti-Soviet war.

Shifting ground

Of course, there have been some extraordinary geopolitical changes since that time. During the 1980s, places like Tajikistan and Uzbekistan were republics of the Soviet Union and provided much of the manpower for Soviet forces, and the anti-government, western-backed rebels found shelter and succour in Pakistan. Now America, fearful that basing an offensive in Pakistan could lead to the collapse of that country's military government, is counting much more heavily on Tajikistan and Uzbekistan as staging posts.

Still, it is hoped that some things have not changed—such as the Anglophile sentiments of the Tajik

warriors. Expertise in liaising with local fighters through special forces may well be the biggest British contribution to the campaign, though it happens that a fair number of Britain's regular sailors and soldiers are also in the region.

How often should Americans use cruise missiles?

American commanders, meanwhile, have some hard choices as they consider how to reinforce low-tech guerrilla operations with high-tech bombs. In particular, they must calculate how often to use one of the sharpest arrows in their quiver: cruise missiles, fired from aircraft or submarines, which in their latest form can achieve deadly, satellite-guided accuracy at a range of 1,500km. American stocks of “smart” munitions are much bigger than they were during the war against Serbia, but the Pentagon will not want to exhaust its supply of cruise missiles, currently estimated at just over 2,000.

The air war over Serbia seemed to prove the effectiveness of large, long-range bombers such as the B-2, based in the United States, and the B-52 which could fly in from the British island of Diego Garcia in the Indian Ocean. What about smaller, tactical fighter-bombers? Several American allies in the region—Saudi Arabia and Bahrain, for example—seem queasy about providing bases. This makes bombers based on aircraft carriers seem more attractive; but sea-based aircraft are relatively short-range. They would need to be refuelled over Pakistan, and the tankers might be easy to attack.

The Taliban are not thought to have very much in the way of anti-aircraft defences. The air defences of Iraq have been growing steadily in sophistication, and they would need to be destroyed before any sustained bombing of that country. Iraq may be a more “convenient” target than Afghanistan, but no front in the forthcoming conflict is going to be easy.

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America's military culture

A sense of history

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The generals are much better prepared than the politicians

HOW well prepared, culturally and psychologically, is the American officer class for the prospect of a long, messy war that could rage from the Potomac river to the Hindu Kush? Vastly better prepared than the nation's politicians and intellectuals, says Robert Kaplan, a foreign-policy scholar who has written books on American military culture—and on warfare in Afghanistan.

America's senior brass have always had a more realistic—that is, more pessimistic—view of both world history and current affairs than its top civilians, in Mr Kaplan's view. The Clinton administration's faith in the onward march of liberal democracy, and its penchant for using armed forces in humanitarian and nation-building roles, were never accepted by the military men, who felt certain that the spread of deadly weapons, extremist ideologies and failed states portended conflict.

A few generals—such as Wesley Clark, who oversaw the American-led bombing of Kosovo—have found favour with liberal intellectuals. But, in Mr Kaplan's view, most senior officers reflect different strands in American culture: the frontier spirit of the west, where the memory of the Indian wars is still alive, or the tough realism of the South, which shares with Europe a collective memory of bloodshed and suffering.

Charles Moskos, a sociology professor who has spent a lifetime studying American military culture, agrees that many American officers have a sense of history. At war colleges, students are introduced to the sweep of military theory, including the 2,000-year-old ideas of Julius Caesar and Sun Tzu. Among recent graduates of these colleges, Mr Moskos has even heard complaints that there is too much emphasis on the past and not enough on the likely shape of future wars.

The forthcoming conflict will provide further evidence of the rising power of America's military "proconsuls"—the generals who head the Pentagon's regional commands. The most likely theatres of the brewing war fall squarely within the domain of Central Command, headed for the past year by General Tommy Franks. Under his high-profile predecessor, General Anthony Zinni, this command became one of the mightiest instruments of American diplomacy. General Zinni never hesitated to speak his mind: while overseeing air strikes against Iraq, he gave warning against the power vacuum that might arise if the Baghdad regime were overthrown with nothing to replace it.

General Franks has been responsible for soldier-to-soldier relations in a host of poorly organised states. The back-slapping ties he has cultivated with brother officers in Tashkent, Islamabad and Nairobi may now be a vital element in America's ability to call in favours.

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Afghanistan and its neighbours

The perpetual vortex

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AP

The Taliban have caused trouble all over Central Asia. Now Central Asia is taking its revenge

Get article background

AFTER five years of Taliban rule, no country in the world has fewer friends than Afghanistan. Of the six countries that border it—Pakistan, Iran, Turkmenistan, Uzbekistan, Tajikistan (all fellow-Muslim states) and China—not one has come forward to argue against the imminent anti-terrorist attack. Pakistan, Uzbekistan and Tajikistan, indeed, have offered assistance to America and its allies. Even China, normally among the shrillest critics of “American hegemonism”, will not rock the boat.

Small wonder. Under the Taliban, Afghanistan has become an exporter of instability that not only affects its immediate neighbours but, as America now knows, reaches much farther afield. Even before September 11th, the Taliban were recognised by only three countries. Since then, two of these have cut diplomatic links; only Pakistan, formally, still has them.

The Taliban's sheltering of Osama bin Laden and his al-Qaeda movement is only one reason why Afghanistan is so feared. Other extremist groups, harboured and supported there, have struck out into Kashmir, into the Fergana valley, where Uzbekistan, Kirgizstan and Tajikistan intertwine, and probably even into China.

For their own reasons, these countries' undemocratic governments have tended to demonise the Taliban. But there is some truth in their charges. The Taliban may not have set out deliberately to destabilise the region; but they have allowed their territory to become a base for the worldwide export of terrorism. Flooded with millions of weapons, infected with the worst sort of religious fundamentalism and plumbing the depths of human misery, Afghanistan has become the world's saddest and most dangerous example of a failed state.

Pakistan: creator and victim?

At the top of the list of vulnerable states comes Pakistan, which is much to blame for the rise of the Taliban in the first place. In the mid-1990s, Pakistan took groups of militant Islamic students (the name *taliban* derives from the Arabic for student) under its wing, helped them recruit new members, and provided the guns, transport, training and battle plans they then used to conquer most of Afghanistan.

Pakistan's motives were no mystery. Locked in a state of near-conflict with India on its eastern border, it needed a friendly Afghanistan to its west. Afghanistan was a convenient place for recruiting and training guerrillas to fight Indian rule in (largely Muslim) Kashmir, the occupation of much of which by India has angered Pakistanis ever since their country became an independent state 50-odd years ago. Afghanistan is also Pakistan's bridge to Central Asia: if there were peace there, pipelines could deliver Central Asian oil and gas to the outside world through Afghanistan and Pakistan.

So, by the mid-1990s, the Taliban won the backing of Pakistan's armed forces, especially the powerful Inter-Services Intelligence agency (ISI). Their other main Pakistani ally was Jamiat-e-Ulema-i-Islam (JUI), a religious party that now attacks Pakistan's support for the American-led coalition. During the 1980s the JUI educated the children of Afghan refugees in *madrassas* (religious schools) in the North-West Frontier and Baluchistan, the provinces bordering on Afghanistan. Primed with the fierce absolutism of the Deobandi Islam they learned, the *madrassas*' graduates flocked to the Taliban's cause.

Pakistan got much of what it wanted from the Taliban, including a nursery for

zealots to use against India. But, in the process, the ISI and other state organisations drew dangerously close to anti-western Islamists, including Mr bin Laden, just as they had earlier been too close to the most radically Islamist of the mujahideen who, with America's help, fought the Russians in Afghanistan in the 1980s. What westernised Pakistanis now fear is that the networks of armed Islamists have taken on a life of their own. One Lahore professional expects that he and his kind will end up with their heads on pikes. An American-led attack on terrorists in Afghanistan, he suspects, will set it off.

One Lahore professional expects that he and his kind will end up on pikes

Like the Taliban themselves, these fundamentalist networks both serve and defy Pakistani interests. Their usefulness is clearest in relation to Kashmir. Pakistan cannot wage a full-scale war against India, which would end at best in defeat, at worst in a nuclear conflagration. So it encourages groups like Lashkar-e-Taiba (Army of the Righteous) and Jaish-e-Muhammad (Army of Muhammad) to send mujahideen into Indian-controlled Kashmir to kill soldiers, policemen and (says India) civilians. These groups have bases in Pakistan and in Pakistani-controlled Kashmir, and training camps in Afghanistan.

Unsurprisingly, given the forces of militant *jihad* (struggle) under its patronage, Pakistan has not been an island of tranquillity. In the 1980s Zia ul Haq increased the country's Islamisation, promoting hundreds of *madrassas* that are now blamed for teaching young men little more than the merits of martyrdom. The years of fighting in Afghanistan brought some 2m refugees into Pakistan, along with countless guns and a culture of religious militancy. In this soil fundamentalist groups, from the pacifically political to the ruthlessly violent, have flourished.

Jaish-e-Muhammad, for example, broke away from Harkat ul Mujahideen, deemed a foreign terrorist organisation by America's State Department. It appears to have close ties to a Sunni group called Sipah-e-Sahaba (Army of the Prophet), a violent foe of Pakistan's Shia minority. A Sipah-e-Sahaba offshoot called Lashkar-e-Jhangvi is thought to be behind a series of recent murders of prominent Shias in Karachi, Pakistan's main commercial city.

Can Pakistan's military-led government control extremist groups?

All these groups stem from (though are not necessarily allied to) the fierce JUI party. Jamaat-e-Islami, Pakistan's biggest religious party, is more peaceable, but is connected to the biggest guerrilla group operating in Indian Kashmir, Hizbul Mujahideen. Although it never does well in elections, its followers are a force to be reckoned with on Pakistan's streets. They have led some of the protests against the idea of anti-terrorist action in Afghanistan.

Can Pakistan's military-led government control them? It has professed to want to curb extremism since taking power two years ago, but has often seemed uncertain about just how to do so. It recently banned Lashkar-e-Jhangvi but at the same time released the leader of its supposed associate group, Sipah-e-Sahaba. It is handling the anti-American demonstrations with a surer touch, though two protesters were killed in Karachi on September 21st.

Most Pakistanis seem to believe their president, General Pervez Musharraf, when he says that the Americans have more to offer Pakistan than the Taliban do. The lifting this week of sanctions imposed on Pakistan by America after its nuclear-weapons tests in 1998 may help to prove his point. But the country's mood has yet to be tested by western missiles hitting Afghanistan. Although General Musharraf should be able to hold the extremists at bay, some of his officers, especially in the lower ranks, are much less keen than he is on making common cause with the Americans.

Trouble in the valley

Pakistan is reaping the whirlwind sown by its own policies in Afghanistan. But the problem faced by the “Stans”, the five former Soviet republics of Central Asia, is different. They have neither supported nor encouraged militant groups in Afghanistan. On the contrary, it is the Taliban regime that has given refuge, training and arms to dissidents from within them. And the Stans, in differing degrees, have reacted so repressively that they have increased the dissidents' appeal.

Not all the five countries are equally affected or to blame. Kazakhstan and Turkmenistan have managed largely to escape the attentions of Taliban-backed groups. The primary target of the Islamists is Uzbekistan, the most populous of the five. The most dangerous Central Asian guerrilla organisation, the Islamic Movement of Uzbekistan (IMU), grew up in the 1990s as a direct result of the

Of the five “Stans”, Uzbekistan has been the

repression of milder forms of Islamic opposition to the rule of Islam Karimov, the Soviet-era placeman who turned himself into independent Uzbekistan's first and only president.

Islamicists' primary target

But their prize, the Fergana valley, the lushest and richest part of Uzbekistan, is also shared by Tajikistan and Kirgizstan, and so these countries too have been dragged into the conflict, and relations between all three have been badly strained. Uzbekistan has upset Tajikistan and Kirgizstan by laying mines along their common borders, often on the neighbours' side.

In return for being allowed to use bases in Afghanistan, the IMU, whose numbers are estimated at 1,000-3,000, has sometimes assisted the Taliban's campaigns against the Northern Alliance. By doing so, they have made themselves too valuable to the Taliban to be surrendered. It is said that Juma Namangani, the young military leader of the IMU, carries a warrant signed by Mullah Omar, the Taliban's leader, designating him as the regime's second-most-honoured guest after Mr bin Laden.

The IMU first came to international attention in February 1999, when Uzbekistan's government accused it of planting bombs in its capital, Tashkent. There was no real evidence, but later that year, the IMU launched an attack on Uzbekistan from bases in Tajikistan, where it had been fighting with the United Tajik Opposition in that country's civil war. The incursion got only as far as Kirgizstan, where the IMU took several hundred hostages. The militants said they intended to overthrow Uzbekistan's government and to establish a caliphate, a form of religious government, in the Fergana valley. They then retreated to Afghanistan, but were back last year. This time, the incursion got within 80km (50 miles) of Tashkent.

To prevent further attacks, the Central Asian republics have tried to strengthen their defences. For this, the price has been high. Across the region, even in once-liberal Kirgizstan, the ruling regimes have cracked down hard on Islamists, and by extension on all forms of opposition. It is hard to avoid the conclusion that they have taken the Islamists' activities as an excuse to tighten their grip on power.

In Uzbekistan, and to a much lesser extent in Kirgizstan, there have been mass arrests of members of a Muslim group called Hizb-ut-Tahrir (Freedom Party), which wants to install a caliphate, across the whole of Central Asia. Unlike the IMU, it insists that its methods are peaceful. Yet the arrest of thousands of its supporters could easily convert it to violence.

The governments of the region are now allied in a number of ways. The bodies they belong to include a Russian-led collective security alliance and the Chinese-organised “Shanghai Six”, which are increasingly aimed at the Taliban. (Russia has a particular animus against the Taliban, accusing them of supporting Chechen terrorists.) Now the Stans are falling into line behind America, too. Uzbekistan and Kazakhstan have been quick to offer the allies the use of its territory for operations against the Taliban. Tajikistan, it is thought, has privately done the same.

Feared even in Beijing

For all its presumed reservations about the exercise of American power, China too feels threatened by radical Islam in Central Asia. The far-western Chinese province of Xinjiang—about 60% Muslim—borders on Afghanistan and Pakistan, as well as on three of the Central Asian republics. There have been angry protests, and some outbreaks of terrorist violence, by people who want to win the region's independence from Beijing.

Western diplomats in Beijing tend to downplay the Taliban's influence in China, saying that Xinjiang's troubles have domestic roots and that these “disgruntled farmers with fertiliser bombs” do not constitute a movement. That does not stop China worrying. In recent months the authorities have arrested a number of militant Muslims; two Hizb-ut-Tahrir cells are said to have been found, one in Xinjiang's capital, Urumqi, the other in the southern city of Khotan.

Diplomats also say that some 200-300 Uighurs, Xinjiang's main ethnic group, are believed to have undergone military training in camps run by the Taliban. Many of these, however, have put their skills to use outside China—in fighting Afghanistan's Northern Alliance, for example, and even in Chechnya. China has attempted to maintain an unofficial relationship with the Taliban in an apparent effort to persuade the authorities in Kabul not to send Xinjiang-born militants back to fight in their homeland. But the danger is there.

China's bid to stay on the right side of the Taliban will have ended if it accepts Operation Enduring

Freedom. But America, China, Russia and the Central Asian states all have to recognise that they need to come together not only to oppose the Taliban but to ensure that it is succeeded by something more stable. If they do not, Afghanistan will remain a source of chaos.

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Saudi Arabia

The double-act wears thin

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Suddenly, it's getting harder to play both sides

AP

WHEN Saudi Arabia cut off diplomatic relations with Afghanistan on September 25th, the decision was hailed as the final step in the international isolation of the Taliban regime. But the most remarkable feature of the action is how slow the Saudis were to take it. The Saudi government sees Osama bin Laden as a threat to its very existence. Yet Saudi Arabia was one of only three countries to recognise his hosts, the Taliban, as the legitimate government of Afghanistan. Even after Mr bin Laden took refuge with them in 1996, Saudi Arabia is said to have helped pay for their drive to take full control of the country. And, now that America is planning to hunt Mr bin Laden down, Saudi Arabia seems reluctant to join the chase.

This reluctance stems in large part from Mr bin Laden's popularity among ordinary Saudis. The royal family's authoritarian rule makes public opinion hard to gauge, but stories abound of his admirers sending one another congratulatory text messages on their mobile telephones after the attacks of September 11th. A more common reaction, according to one Saudi, was suspicion that America was trying to frame Mr bin Laden because of his opposition to American involvement in the Middle East. At any rate, many Saudis sympathise with his denunciation of America's "indifference" to the plight of Palestinians under Israeli occupation and Iraqis under United Nations sanctions.

Reuters

Saudi officials, conscious of the growing criticism of America, have long tried to play down the two countries' ties. They have pursued, for example, a rapprochement with Iran. Several years ago, the government moved most American forces in the kingdom to a remote desert air base. Earlier in the year, with the Palestinian uprising in full swing and popular consternation at its height, the Saudi regime began to put pressure on America to stop using aircraft based in its country for attacks on Iraq. No wonder, then, that the Saudi government reacted with horror and confusion when American officials declared that they were using a Saudi air base as headquarters for any retaliation against Afghanistan.

Criticism of the kingdom's ties to America is not the only theme of Mr bin Laden's that strikes a chord with the Saudi public. He also fulminates against the godlessness of the royal family, some of whom do indeed seem more comfortable at parties in Geneva than on pilgrimage to Mecca. In the past, the family's long-standing alliance with the puritanical Wahhabi sect helped to

shield it from such censure. But, whenever Islamist protest swelled, the regime's standard response was to co-opt its critics by burnishing its Islamic credentials. The net result is that the clergy—many of them reactionary by western standards—now wield enormous sway over everything from school curriculums to municipal building codes. And, in foreign policy, Saudi Arabia has long tried to cast itself as the global sponsor of conservative Islam. Hence its support for movements such as the Taliban.

Not exactly comfortable

That policy has now come home to roost. As many as 25,000 Saudis have, like Mr bin Laden, travelled abroad to fight for the Muslim cause in places such as Bosnia, Chechnya and Afghanistan, according to Saad al-Faqih, the leader of a London-based opposition group. Many of those have since returned home to raise money or recruit new volunteers for militant groups. Several of the hijackers involved in the attack on America were Saudis, even if some used false identities. Although violent fanaticism is just what the government was hoping to avoid, it seems to arise fairly directly from the sort of uncompromising religiosity the government has encouraged. As one Kuwaiti anxiously puts it, “The Saudis have been playing both sides for a long time, but now they have to make up their minds.”

In fact, as always, the Saudi regime is likely to dwell on its response for some time. It has faced down unrest before. Unlike the last serious bout of Islamist agitation, in the mid-1990s, the present surge features little open criticism of the government. Mr al-Faqih admits he does not expect public protests in the event of an American attack on Afghanistan. But even if opposition to the regime is shallower this time, it is also more widespread and diffuse, and so harder to combat.

One Saudi who has been doing the rounds of locals' evening get-togethers says the tenor of ordinary conversation has become much more critical of the government. The Saudi authorities will find it extremely hard to stop their citizens giving money to Islamic charities that turn out to be fronts for extremists. Recruitment and fund-raising can take place during a visit to the mosque, or over a quiet cup of tea at home. And no one knows how long the anti-terrorist campaign will last, or how much resentment it will foster.

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Wider worries in the Muslim world

America's second task

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It will be an uphill battle to bring opinion round

IN STRIKING back at the terrorists who perpetrated the slaughter of September 11th, America has a dual aim: to stamp out the attackers, wherever they may be, and to deny them their goal of rallying Muslims to their cause. Both battles will be fought in inhospitable terrain. Just as the Afghan landscape provides perfect cover for bands of fugitives, a decades-long ebbing of sympathy with America has left a residue of stony hearts and muddled minds across the Muslim world.

This is not to say that the reservoir of goodwill has dried up completely. Far from it. A fondness for America and things American permeates far beyond the richer sorts of Arabs and Muslims, the people often described as isolated by their pro-western leanings. Vital mutual interests link America to the countries that spawned Osama bin Laden and his cohorts, including the need, now reinforced, to curtail the terrorist groups that threaten many Muslim and Arab regimes much more directly than they do America.

And yet America and the Muslim world—particularly its Arab component—have drifted apart. So far apart, indeed, that popular mistrust of America in the region is now the biggest single handicap to mobilising the war on terror that the West so keenly wants to win.

The fault is certainly not all America's. Simply being the most powerful and pervasive culture and economy in history inspires a prickly defensiveness everywhere else. If this is true in the cafés of Western Europe, it is even more true in the socially fractured, politically stunted nations of the Middle East.

Three main factors influence the way these countries respond to American power. One is the growing politicisation of Islam. Islamist movements have found America a useful counterpoint to their own, sometimes vague, ideas. Early on, the welcome American principles of democracy and freedom were sanitised into an Islamic mould. What was left was a list of “American” ills to stand against: crime, adultery, broken families, homosexuality, materialism and so on, along with a supposed desire to enforce this purported American way of life across the planet.

A second influence on attitudes to America is the dismal record of governments in the region, many of which are propped up by American aid or arms. To Americans, this support looks like the price they pay for stability. To many Arabs and Muslims, burdened with poor housing and schools and restricted freedoms, it looks like the price they pay to ensure American hegemony. Recognising this, America's friends have increasingly felt obliged to bite the hand that feeds them.

A third influence is America's growing tendency towards unilateralism. Kicking sand in the face of dictators goes down better in Kansas than in Kandahar. Even America's better-intentioned solo efforts have earned opprobrium. The 1991 Madrid peace talks led to the Oslo agreement between Israel and the Palestinians, after which America pushed other interlocutors out of the way. A decade later, Israel had doubled its settlement of the occupied territories and the Palestinians erupted in revolt. For all its protests that it has tried to be an honest broker, America cannot shake the impression that it was fiddling while Gaza burned.

Kicking sand in the face of dictators goes down better in Kansas than in Kandahar

The result? On the streets of Cairo today, it is hard to find a soul who admits to believing the FBI's version of events on September 11th. Many are convinced that the whole thing was a plot to smear Arabs and Muslims as crazed madmen. More will have read the writings which suggest that America's

real intention is to capture Afghanistan to keep China out of the Gulf.

The wild speculation is partly a knee-jerk product of ignorance, both about the extent of the human loss in America and about how open societies generate information. But, to recapture credibility, America has to show understanding of its allies' need to manage public opinion.

For example, the more agile of Arab leaders, such as Jordan's King Abdullah and Egypt's Hosni Mubarak, have assured their people that they will not jump aboard any American train without knowing where it is going. Moderate religious leaders have chimed in, saying they share America's pain, but fear its response. These calming voices would be greatly helped if America were to release some really solid proof of who did the vile deed, followed up by patient explanation. They would be helped even more by a reminder that the UN's charter provides authority for American action—and by sustained American action to douse those flames in Gaza.

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The war against terrorism

Big government is back

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But how much? For how long? And with whose assent?

WARS are fought by soldiers but organised by governments. Most conflicts therefore tend to increase the power of the state, at least temporarily. America's war against terrorism is no exception. In the two weeks after September 11th, the country has seen a sharp increase in the role of the federal government.

On September 14th, three days after the attacks, Congress appropriated $40 billion in emergency spending and then approved, in record time, a $15 billion rescue for airlines. On September 20th, President George Bush announced a new federal Office of Homeland Security. John Ashcroft, the attorney-general, wants to expand the powers of the FBI and the CIA. Other people want to increase the federal government's role in providing security for vulnerable targets such as airports and nuclear-power stations.

None of this is surprising, or necessarily permanent. After all, national defence is the prime responsibility of the state. When it is threatened, people naturally rally round, and the government's work becomes more visible. It happened in 1941 and again in the mid-1960s, at the start of the Vietnam war. This time, America is also facing a recession, increasing the call for public spending in another area.

Still, the change represents a remarkable about-turn for a president who came into office saying "[Al Gore] trusts the government; I trust the people" and who wanted to limit the scope of federal spending by cutting taxes. Mr Bush now finds himself presiding over the most visible rise in government activity for years.

The most obvious example is the proposed new Office of Homeland Security to be headed by the governor of Pennsylvania, Tom Ridge (see Lexington). This would be the first new job to be created at cabinet level since 1989. Mr Bush wants Mr Ridge to co-ordinate the 40 or so government departments involved in protecting Americans from terrorists at home. This in itself would not necessarily expand federal powers; it would merely rationalise them. But some in Congress want to go further, setting up a new department.

When people think of "big government", though, they think of large spending increases and new federal programmes. Congress has so far approved $55 billion in extra cash, with more to come (see next story). Some money—such as the $2 billion going to the Federal Emergency Management Agency—will be temporary. But not all will be. It is striking that Congress, a body normally fierce to guard its control over

federal spending, has given the president free rein to spend $20 billion more or less as he wishes.

For civil libertarians, a bigger issue is the demand for extra authority, rather than extra money. Mr Ashcroft wants Congress to increase law-enforcement powers in four ways. The first two methods have plenty of support in Congress; the other two do not.

•**Eavesdropping.** The current wiretapping law dates from 1968, before mobile telephones and multiple lines. It requires a separate court order for each telephone number in each jurisdiction. Mr Ashcroft wants wiretapping authorisations to apply to the suspect, not the line, so that surveillance can continue when a suspect switches telephones or uses a mobile phone in a new place. Investigators also want to seize unopened e-mail and voice messages with a search warrant, not a court order.

•**Defining terrorism.** At the moment, harbouring a terrorist is not a crime in America. Mr Ashcroft wants to bring the law into line with those on harbouring spies and drug-dealers. The term terrorist would include those who support terrorist organisations. He also wants to eliminate the statute of limitations on terrorist crimes (now five to eight years). As with wiretapping, most congressmen see this as merely filling a gap in the existing law.

•**Detaining suspects.** Mr Ashcroft wants discretion to detain foreigners held to pose a threat to national security. The detention would be without trial and with only minimal judicial oversight. Opponents think this would, in practice, make detention indefinite. Many congressmen also fear that it would increase the government's powers of surveillance in other areas of law enforcement, not just terrorism.

•**Uses of intelligence.** The attorney-general wants intelligence agencies to get information from law-enforcement ones (including secret grand-jury testimony). This has been banned because the FBI abused this power in the 1960s to harass Martin Luther King, among others. Mr Ashcroft also wants to permit intelligence gathered by foreign governments to be used in American courts, even if the gathering would have been illegal in America. Opponents say this would be unconstitutional.

The White House hopes that Mr Ashcroft's anti-terrorist measures can be passed quickly. He will get some of what he wants. But it is notable that his package has not flown through Congress, as the economic bail-outs did. The civil libertarians' opposition will not easily be overcome, partly because it is bipartisan. In the Senate hearings, some of the sharpest questions came from Republicans. In the House, the most left-wing member of the judiciary committee, Maxine Waters, shared the reservations of the most conservative member, Bob Barr—the first time the two have agreed on anything.

Soft targets

Another mooted area of bigger government—guarding vulnerable targets—faces practical as well as philosophical, doubts. At nuclear-power stations responsibility for security is shared between the Nuclear Regulatory Commission and the owners. The NRC had been thinking of giving the utilities more responsibility for security. It now looks likely that, instead, there will be greater federal involvement.

The bigger mess is air travel, where the Federal Aviation Administration sets guidelines but leaves the rest to airports and airlines. Senators of both parties want the FAA to take over the baggage-screening business. The stereotypical screener is poorly trained and on the minimum wage. Under the Senate plan, they would become federal employees in a new security division of the FAA. Mr Bush's transport secretary, Norman Mineta, fears it would take too long to hire and train 28,000 new civil servants. He wants to bring in federal training and performance standards—an idea approved by Congress in 1996, but not implemented.

The most important effect may be cultural. In the 1980s, Ronald Reagan declared that “government is not the solution to our problem; government is the problem.” At a time when America's heroes are its firemen and its rescue workers, government seems to be at least part of the solution. This feeling, like Mr Bush's sky-high poll ratings, could be ephemeral. But Robert Hormats, a vice-chairman of Goldman Sachs, thinks it will last. “We will to have to spend more money on the war and to get us out of recession. We will have to spend more on domestic security. And our spending on defence will go up, pulling more people and more technology into the governmental sphere.” These things could halt—or at least slow—the erosion of faith in the federal government that has marked American politics for a generation.

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The economy

Bang for the buck

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What kind of tax cuts or spending would do most to boost the economy?

AS EVIDENCE mounts that America's stumbling economy has fallen down, Washington is abuzz with efforts to get it back on its feet. Figures released on September 25th show that consumer confidence fell to a five-year low in September, the biggest monthly drop since Saddam Hussein invaded Kuwait in 1990. With layoffs rising fast while profits plunge, things could get much worse.

As a result, looser monetary policy is inevitable. The Federal Reserve is universally expected to lower interest rates when it meets on October 2nd, and probably again thereafter. But after aggressive loosening (short-term interest rates have fallen from 6.5% to 3.0% since January), the central bank does not have infinite ammunition. Hence the politicians' focus on fiscal policy. Congress has already agreed to spend $40 billion for disaster recovery and heightened security, as well as $15 billion on grants and loan guarantees to bail out the airlines. And there is more to come.

In the White House, George Bush's top economic advisers and cabinet secretaries meet daily in a “Domestic Consequences Policy Committee”. They are working on an “Economic Recovery Package” that is likely to include more tax cuts, more spending, regulatory reform to help businesses, as well as more aid for specific hard-hit industries. The administration has said little publicly about the size of the package or what kinds of measures it favours. Privately, Mr Bush's economic team is pushing for a cut in the corporate income-tax rate, partly in the hope that it would boost the stockmarket.

In public, Congress rather than the White House is shaping the stimulus debate. Top Democrats and Republicans are (unusually) talking to each other, as well as seeking outside advice on what to do. Not surprisingly, Alan Greenspan, still America's most revered economic figure, has played a big role. He has been to Capitol Hill three times since September 11th. Last week, he stopped a headlong rush to pass stimulus measures within days by suggesting that it was important to wait until a clearer picture of the economy emerged.

The other important figure has been Robert Rubin, formerly Bill Clinton's highly regarded treasury secretary. Mr Rubin, too, has seen lawmakers three times, playing a noticeably more visible role than the current (less highly regarded) treasury secretary, Paul O'Neill.

Both men seem to agree on broad outlines for a fiscal package. To be effective, the amounts involved have to be significant. Mr Greenspan has suggested perhaps 1% of GDP or $100 billion in total (including the airline rescue and emergency spending). The measures should be temporary, targeted at boosting consumer and business spending in the short term without creating long-term fiscal problems. Any possibility of future fiscal weakness, argue Messrs Greenspan and Rubin, would push up long-term interest rates, in turn undermining the stimulus.

These (sensible) criteria rule out many of the proposals floating round Washington. A cut in the capital-gains tax rate is costly and would not boost short-term consumption—indeed its advocates have long promoted the idea as a means to boost saving. Cutting the corporate income-tax rate (as the Bush administration favours) is also expensive and would do little to reward new corporate spending. Bill Gale of the Brookings Institution reckons a one-percentage-point cut in the corporate tax rate would cost $90 billion over a decade, including interest costs. Mr Greenspan is a fan of cuts in both capital-gains taxes and corporate income-tax rates, so his reluctance to push them now is a strong negative signal.

Everywhere a rebate

That leaves the focus on temporary tax measures, as well as more spending. Temporary ways to boost business investment include an investment tax credit, accelerated depreciation schedules or higher expensing limits. History suggests investment tax credits are reasonably effective at stimulating business investment, though the impact during an investment-led economic downturn might be much weaker.

A popular idea for boosting consumption quickly is another tax rebate. This would be based on the payroll tax and targeted at poorer Americans, many of whom earned too little to receive an income-tax rebate earlier this year, and who tend to spend the highest proportion of their income. Gene Sperling, one of President Clinton's top economic advisers who is now at the Brookings Institution, suggests a “Christmas Holiday Shopping Tax Credit” of, say, $300 each for the bottom 60m-70m taxpayers.

But would this cash really be spent? Economists reckon that people change their spending patterns in response to permanent tax cuts, not temporary ones. Even the income-tax rebate earlier this year was part of a package of permanent cuts. And while analysis of previous rebates suggests that people end up spending between one-third and two-thirds of the money, early evidence suggests the proportion this year may be much lower. Joel Slemrod of the University of Michigan cites a survey in August which showed that only 17% of people intended to spend the income-tax rebate they were granted earlier this year. Worryingly, poorer people were less keen to spend the money than richer ones.

Government spending would be more certain to boost the economy. And that is clearly on the rise. From travel agents to hoteliers, industries want bail-outs. Politicians are already plotting spending projects. Harry Reid, a leading Democratic Senator is talking about $100 billion in new spending largely on transportation over the next few years. Whatever its long-term merits, such infrastructure spending is unlikely to be much help in the short term. America's politicians may soon find out that it is easier to talk about fast fiscal stimulus than it is to achieve it.

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Biological and chemical warfare

Fear and breathing

Sep 27th 2001 | BEEDEVILLE, ARKANSAS, AND LONDON
From The Economist print edition

The threat of biological or chemical terrorism is small, but still scary

YELLOW crop-dusters are as common a sight round Beedeville as farmers' pick-up trucks. At this time of year, they normally buzz above the fields that surround this tiny rural town, spraying their mist of chemicals on cotton, rice and soybean crops. Not for much of this week. Reports that one of the hijackers had shown an interest in crop-duster aircraft fed fears of bioterrorism, and the Federal Aviation Administration grounded them on September 23rd. The ban was later rescinded, but the townsfolk of Beedeville are still frightened that smallpox, anthrax or mustard gas might fall on them from the skies.

They are not alone. Americans are stocking up on gas masks and antibiotics. But how likely is it that terrorists would use chemical or biological weapons?

Possible but—at least for the moment—improbable, is the vaguely reassuring reply from many experts. As Julian Perry Robinson, at the University of Sussex, points out, the risk of a biological or chemical attack depends on three things: access to raw materials; the technical skills to deploy them; and a willingness to cause mass destruction. The last is no longer in doubt. The first two are hard to meet.

Getting together deadly substances in sufficient quantity to kill thousands is neither cheap nor easy. To be sure, some nasty chemicals, such as organophosphate pesticides, can be bought off the shelf or hijacked as they are transported across the country in lorries. Other more toxic substances, such as mustard gas, can be manufactured fairly easily. But the real killers—the nerve agents sarin and soman—are fiddly to make.

Even putting together the basic recipe would require time and knowledge. And, as Milton Leitenberg of the Centre for International and Security Studies at the University of Maryland points out, making high-grade nerve agents is more than cookbook chemistry: it takes a fair degree of expertise to know, for example, which catalysts to use in the reactions and at what temperature. Aum Shinrikyo, a Japanese cult, put about 30 people and an estimated $30m into producing sarin; yet the stuff they released in the Tokyo subway in 1995 was less than 20% pure.

Beyond the scientific hurdles are industrial ones. It takes a lot of chemicals to do a lot of damage, so what is needed is a sizeable manfacturing facility, not just a bathtub in a basement. Although a few molecules of sarin are enough to kill a person, it takes hundreds of pounds of chemicals to achieve that concentration in an open-air attack. Attacks in enclosed spaces require less chemicals, but both sorts expose handlers to risk during both preparation and delivery. It is a risk to deter all but suicide-bombers.

Biological agents are even harder to turn into weapons of mass destruction. Not all strains of, say, anthrax or plague bacteria are equally deadly. Growing the right ones in the lab, keeping them pure and virulent, is also tricky. But toughest of all, according to David Franz who heads the chemical and biological defence division of the Southern Research Institute in Frederick, Maryland, is delivering the goods. Bacteria and viruses can penetrate deep into the lungs (and therefore cause damage) only if they are broken up into tiny aerosol particles. It takes a lot of energy to turn the average liquid culture into such a fine spray. Exploding a warhead would be one way, but that would probably kill most of the micro-organisms intended for delivery.

No wonder those bent on mass mayhem have chosen “simpler” methods, such as hijackings and bombings. But this could change as security tightens. In that event, Dr Franz reckons that chemical weapons are more likely to be tried than biological ones, since the effects are more immediate and predictable.

A worrying exception could be smallpox. The virus is highly infectious. Because the disease was eradicated 20 years ago, most people have no immunity, so an outbreak could spread rapidly. There are only two official repositories of smallpox virus in the world, in the United States and Russia. America has 7.5m doses of vaccine on hand, and has ordered another 40m for good measure.

Since 1998, the federal government has more than doubled spending on defence against biological and chemical weapons, creating a new agency within the Centres for Disease Control and increasing national stockpiles of essential medicines to deal with an attack. As a new report from the World Health Organisation recommends, the best way to cope with biological terrorism is good surveillance and rapid response. Doctors and nurses need to be trained to spot unusual symptoms and report them promptly to public health authorities which must, in turn, quickly recognise unusual disease patterns.

America, like most countries, is far from such a co-ordinated response. It did not need a terrorist to import new diseases such as West Nile fever, or AIDS. Indeed, one of the main arguments for better public-health systems is that they would help to protect places such as Beedeville against Mother Nature as well as terrorism.

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Espionage and Cuba

Low Fidelity?

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Cuba may have had an agent at the heart of the Pentagon

AT ANY other time it would have been a “security alert” across the front pages of the American press. Yet even now that Kabul looms larger than Havana in the public mind, the arrest of Ana Belen Montes, on charges of spying for Cuba, is a mighty embarrassment to the Pentagon.

When she was arrested on September 21st, the 44-year-old Ms Montes was the senior Cuba analyst at the Defence Intelligence Agency, the Pentagon's intelligence branch. A 16-year DIA veteran, she had specialised in Cuba since 1992 and had enough seniority to see a wide range of classified material. One source describes her desk as “a clearing house for all sorts of intelligence information”. One piece of information she is alleged to have handed over to her controllers in Havana was the identity of an American intelligence officer operating under cover in Cuba.

Cuban-American exiles are already arguing that Ms Montes's arrest raises questions about the Pentagon's general devaluation of Cuba as a threat to the United States. The Cuban American National Foundation, the most powerful exile group in Miami, thinks that Fidel Castro possesses biological-warfare technology and also keeps friendlier relations with Iraq than the Pentagon thinks (though in four decades of power in Havana, Mr Castro is yet to take offensive action against the United States).

The court papers allege that Ms Montes used pay telephones to contact her Cuban handlers by calling their beepers and entering prearranged code numbers. During a snooping raid on her flat on May 25th, FBI officials supposedly found on her laptop various tips on radio codes, including numerical sequences identical to those allegedly used by Cuba on short-wave transmissions. There was also a message to Ms Montes from her alleged handler, praising her for her help in unmasking the American spy in Cuba. “We were waiting here for him with open arms,” read one communication. It is not clear what happened to the American agent.

Ms Montes's arrest comes only three weeks after FBI agents detained two alleged Cuban agents in Florida, who are charged with trying to infiltrate the armed forces' Southern Command headquarters in Miami, which oversees operations in Latin America. Five other spies were convicted earlier this year in Miami, and sentenced to long prison terms. In their trial the defence lawyers argued that the spies were so comically inept that they barely justified the name. Ms Montes, if proven guilty, would represent an enormous step up in the Castro government's efficiency. An “army brat”, believed to be of Cuban or Puerto Rican descent, she was born in Germany and holds a masters degree from the School of Advanced International Studies at Johns Hopkins University.

She is suspected of working for Cuba for at least five years. Her motive is unclear. Cuba is not known for paying its agents well. Two possibilities: an unsuspected ideological sympathy with Cuba's communist regime; or, perhaps, a love affair.

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Politics in New York

Don't go, Rudy

Sep 27th 2001 | NEW YORK
From The Economist print edition

New Yorkers want to keep their current mayor for another term. Slim chance

Reuters

Would he really vote for anybody else?

WHEN the terrorists attacked the World Trade Centre on September 11th, voting was already under way in the primary election for New York's next mayor. By the time the (postponed) primary was completed on September 25th, hardly anybody wanted a new mayor.

Thanks to his courage during the crisis, Rudy Giuliani, the Republican incumbent, would have won by a landslide had he been on the ballot. Indeed, around 15% of Republican voters wrote his name on their ballots, in preference to the official candidates, and exit polls suggested that most Republicans and over 40% of Democratic voters would have backed him if given the chance. Even Ed Koch, a former mayor and author of “Giuliani: Nasty Man”, said he would now vote for Rudy.

Mr Giuliani would clearly like to stay on. He is due to step down, at the year's end, only because term limits (which he has long supported) require him to do so. The current law, passed in 1993, restricts elected city officials to two consecutive four-year terms. As *The Economist* went to press, he began to discuss a secret plan with the candidates to replace him, their united support for which, he said, would be “in the best interests of New York”.

The negotiations seem to have focused on whether his successors would back a scheme extending Mr Giuliani's term by two to three months. Such a short-term deal might be possible. But he has also made it clear that he has not given up on the idea of scrapping term limits.

Mr Giuliani would need all his political charm—which, frankly, does not work on everybody—to pull off any long-term change. The only card Mr Giuliani has is public opinion, which could evaporate fast if it seemed that the mayor was putting himself before the city. Either the city council or (as the legality of it doing so is disputed), more likely, the state assembly would need to vote in favour of scrapping term limits, allowing Mr Giuliani on to the ballot after the current cut-off date. The state assembly is controlled by Democrats.

Failing any co-operative solution, there has been talk that Mr Giuliani might even offer himself as a write-in candidate; given New Yorkers' current affection for him, plenty of them would happily write his name in. Some constitutional lawyers reckon that Mr Giuliani could, if he won as a write-in candidate, escape the term limits by resigning immediately and thereby not completing his second term of office. But that might take things to the courts, which could decide against him.

Assuming that Mr Giuliani eventually quits whilst he is ahead, the race will be between the Republican primary winner, Michael Bloomberg, a billionaire businessman, and the winner of the Democrats' run-off on October 11th between Fernando Ferrer and Mark Green. Although Mr Ferrer won more votes than Mr Green this week, he did not reach the 40% needed to avoid a run-off. Mr Green is the favourite, since he is likely to take most of the votes that went to the two eliminated candidates, both more moderate than the left-wing Mr Ferrer. If more whites vote in the run-off, that would also help Mr Green defeat his Latino rival, who got only 7% of the whites' votes this week.

Should Mr Ferrer, whose campaign has promised higher taxes and made much of alleged racism in the police force, after all be the Democratic candidate, Mr Bloomberg will have a good chance of winning the

mayor's job for the Republicans. But whoever wins may find his victory somewhat Pyrrhic. Rumour says that President Bush will set up a federal agency to rebuild lower Manhattan, and will ask Mr Giuliani to run it. He might become the “people's mayor”, whoever occupies City Hall.

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The investigation

Hard evidence would help

Sep 27th 2001 | WASHINGTON, DC, AND LONDON
From The Economist print edition

The hunters are struggling

IN THE biggest manhunt in American history, some 7,000 American agents continue to scour the country for clues. Some 350 people have already been arrested or detained; another 400 are being hunted for questioning. Despite a mass of circumstantial evidence—one suspect was apparently found with a computer file named “killpresidentbush.exe”—few of those in custody are co-operating.

The hunt is now spread out around the world. A few dozen men with suspected links to Islamic terrorism have been detained in Britain and Germany (where several of the hijackers may have stayed) and the Philippines (where Islamic rebels are thought to receive money and weapons from Osama bin Laden). French anti-terrorist police are holding several people in connection with a suspected planned attack on the American embassy in Paris.

Yet hard evidence is in short supply. Colin Powell, the secretary of state, first promised to publish details proving that Mr bin Laden was behind the terrorist attacks; then he rescinded his promise. None of those detained in America has yet been charged with a terrorist offence. Most are being held for immigration violations, traffic offences or other petty wrongdoings.

The 19 hijackers are all dead. Hunting down their associates is proving tricky, not least because some of the dead hijackers appear to have stolen the identities of innocent men. The FBI has already admitted that some of the first names it released for the terrorists were false. One Saudi Arabian diplomat claims that his government believes that most, if not all, of the hijackers were using aliases.

Some of the investigative energy has been (rightly) side-tracked into trying to prevent other attacks. Fears of bioterrorism rose when it emerged that at least one hijacker visited a municipal airport in Florida several times to learn about crop-dusting aircraft. Similarly, around 20 of the current detainees had either obtained or tried to obtain special drivers' licences allowing them to transport explosives, poisons or other hazardous materials. The trucking industry has been warned to watch for suspicious activity in connection with radioactive waste and other hazardous chemicals.

For the moment, the financial paper-trail looks the most intriguing (see article). On September 24th, George Bush signed an order freezing the assets of 27 individuals and organisations alleged to have terrorist links, and urged other countries to follow suit. But paper trails often dissolve: witness the difficulties in stopping drug dealers from laundering money. Many terrorists prefer to carry their money in cash, or rely on informal networks of friends. Mr bin Laden also has a record of giving his cells a single lump sum and then requiring them to finance themselves.

Ironically, if Mr bin Laden did make a fortune short-selling shares in insurance companies and airlines, that might leave a better trail. Even the strictest banking-secrecy laws can be waived in cases like this one. But that would still be circumstantial evidence. What America desperately needs is hard proof linking Mr bin Laden directly to the hijackers.

One striking aspect of the attack is that it appears to have been perpetrated on a tiny budget. Apart from their flying lessons, the hijackers lived frugally. They stayed in cheap motels, drove ten-year-old cars, cooked their own food and did their own laundry. Their only extravagance seems to have been a few visits to strip clubs. The weapons they used to seize control of four aircraft—box-cutters and knives—could have been bought for a handful of coins. One estimate put the cost of the whole operation at a mere $2m.

If a vast terrorist plot can be executed on a small budget, then President Bush's promise to “starve

terrorists of funding” may be beside the point.

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Charitable giving

Too much

Sep 27th 2001 | NEW YORK
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Will other charitable causes suffer?

AMERICANS have never been very good at moderation. Warehouses near New York city are stacked so high with granola bars, toothbrushes, baby wipes and other unusable gifts that officials have cried “enough!” As for cash, the total raised for the terrorists' victims in 20 days—nearly $600m—is six times the total amount raised by the American Red Cross after Hurricane Andrew. This time, the Red Cross has raised over $200m, compared with $10m after the Oklahoma city bombing. One telethon with Bruce Springsteen and other stars netted more than $150m.

Companies have been particularly busy. According to New York's Foundation Centre, corporate contributions total $310m, including $10m from General Electric and Merrill Lynch, and up to $20m from ExxonMobil. Some companies' pledges are in kind: AT&T is supplying $10m in phone cards and phones for rescuers. A striking amount of the giving has been online. In his speech to Congress, President Bush plugged LibertyUnites.org, which is sponsored by six technology firms.

But where does all the money go? For now, mostly nowhere. The government, after all, is footing most of the clean-up bill. In New York, the city is paying firefighters and policemen. It will pay pensions to widows of those who died on duty. The federal government has also promised $20 billion to rebuild this part of Manhattan.

The Red Cross is sending $100m-worth of cheques to families of the needier victims. But many groups are sitting on their money. Lack of co-ordination has not helped. The relief groups are used to natural disasters that wreck the homes of poor people. This is a different sort, in that it is one in which a lot of wealthier people have been thrown out of their offices. Daniel Borochoff of the American Institute of Philanthropy points out that shelter, a usual relief staple, isn't needed.

An increasing worry is that non-terrorist causes will get much less. The Sierra Club and the National Multiple Sclerosis Society were among the bodies that shelved fund-raising efforts for two weeks after the attack. Now some think that Americans, the world's biggest donors, may be “given out” after the disaster. With a weakening economy, the outlook for some causes—especially overseas ones—could be grim.

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Lexington

Into the maze

Sep 27th 2001
From The Economist print edition

Tom Ridge has been handed one of the most difficult jobs in government

SUCH unanimity is remarkable, even in wartime. Everybody in Washington welcomes George Bush's decision to put the governor of Pennsylvania, Tom Ridge, in charge of “homeland security”. Everybody agrees the current system is a mess. And they all seem to worry that his chances of success are slim.

This is no reflection on Mr Ridge. A governor of a big state who has spent time in both the army and Congress, he has about as good a CV as you can get for the new job. He is far tougher than his urbane exterior suggests. He made it to Harvard after a childhood in a housing project. He served as an infantryman in Vietnam. And he built a career as a Republican in a strongly Democratic region. Mr Ridge delights in taking on entrenched bureaucracies: as a governor, he has done valiant battle with both the teachers' unions and the welfare establishment. But he also has a talent for coalition-building. He made friends on both sides of the political divide by championing two of the country's most emotive causes, abortion rights and school choice. “I'd walk on hot coals for Tom Ridge,” says John McCain, a man worth listening to.

Yet Mr Ridge's new job will test these skills to the maximum. The current system looks like something that Osama bin Laden might have designed with the express purpose of slipping his killers into America. Responsibility for domestic security is scattered among 40 federal bureaus and offices housed in 20 government agencies, which in turn report to two dozen congressional committees. Many of these groups are more interested in protecting their turf than in fighting terrorists. Computer systems are incompatible. Lines of communication are strained. Two of the terrorists who took part in the horrors of September 11th were able to enter the country and buy airline tickets even though they were on the FBI watch-list.

Everywhere you look there are signs of laxness and confusion. The National League of Cities reports that a third of the country's cities have no plan to deal with any sort of terrorist attack. The Nuclear Regulatory Commission admits that the country's 100 or so nuclear reactors were not built to withstand the impact of a jet airliner. The system abounds with woolly names such as the Centre for Domestic Preparedness and the Critical Infrastructure Assurance Office. The latter is hidden in a corner of the Commerce Department, and has only a $5m-a-year budget. The Centre for Domestic Preparedness, one of the few places that teaches civilian emergency workers how to deal with deadly chemicals, has managed to train a mere 6,000 people out of a relevant workforce of 11m. Last week two of its 80-bed

dormitories, and over half of its 25 classrooms, were empty.

Ways and means

How can this disastrous mess be fixed? Two schools of thought are currently slugging it out in the capital: the minimalists, and the institution-builders.

The minimalists want Mr Ridge to be a tsar, with a seat at the cabinet table but no department. They argue that this arrangement will avoid any need to rearrange the administration and get congressional approval for senior appointments. The essence of the new job, they point out, is always going to be co-ordination. So why go to the trouble of inventing a new bureaucracy? And why endure the rigmarole of having to get your senior staff confirmed by Congress?

The minimalists scoff at the criticism that the new security tsar will be powerless. The closest model for the new office, they argue, is the National Security Council, which co-ordinates the work of diplomacy, defence and intelligence. And nobody could accuse either Henry Kissinger or Condoleezza Rice of being powerless. This is more or less the White House's position.

The institution-builders retort that there is no substitute for having direct control over both a departmental budget and a departmental staff—and that anybody who thinks otherwise should study the dismal careers of Washington's various energy and drug tsars over the years. Earlier this year a bipartisan panel headed by two former senators, Gary Hart and Warren Rudman, drew up a detailed plan for rolling four government agencies, including the border-control agency and the customs service, into a single homeland agency. There is plenty of support for this on Capitol Hill at the moment.

Will the struggle between the rival bureaucracies distract attention from the job of protecting America? There are two reasons for optimism. The first is that a benign compromise may evolve from the clash between the two. Mr Ridge will inevitably start off with limited resources. But a combination of congressional pressure and Mr Ridge's own lobbying may provide him with a growing empire. Two senators have already introduced legislation to give him a budget. Other legislators promise to put forward bills creating a new super-agency against terrorism.

The second reason for optimism is that Mr Ridge already possesses the most valuable resource in Washington: a close relationship with the president. The two men have known each other since 1980, when Mr Ridge worked as a lieutenant in George Bush senior's first presidential campaign. They later cemented their bond when they were both elected governors in 1994. Last year Mr Ridge was in the running for the vice-presidential nomination (but his pro-abortion stand eventually ruled him out). The two have been seen together so often recently that Mr Ridge is being dubbed “the first friend”.

The friendship will be vital as Mr Ridge defines his job. In this new war, terrorists already have an extraordinary range of advantages. They can shift at will from one battlefield to another. They can strike from a thousand hidden places. They can exploit the liberties free men take for granted to wreak terrible destruction. It would be a tragedy, to put it mildly, if bureaucratic squabbling unnecessarily held the door open for them.

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Latin America's economy

Drowning in cheap coffee

Sep 27th 2001 | MEXICO CITY AND PATROCINIO, BRAZIL
From The Economist print edition

A slump in the price of coffee is adding to economic misery in Latin America—and no relief is at hand

Get article background

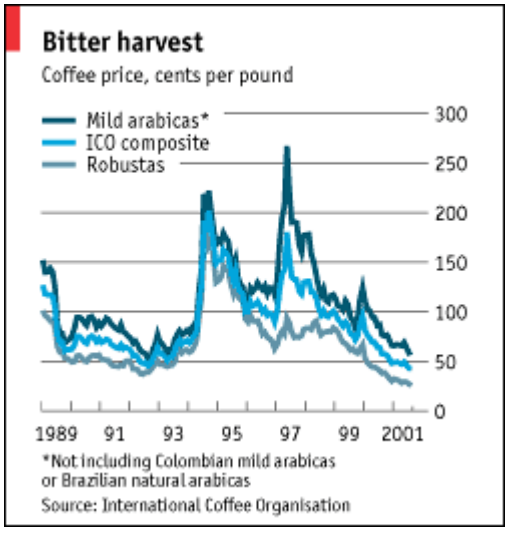
Reuters

A long way from cappuccino economy

IN NICARAGUA, coffee pickers with malnourished children beg for food at the roadside. In Peru, some families have abandoned their land, while others have switched to growing drug crops in search of cash, just as they have in Colombia. From Mexico to Brazil, tens of thousands of rural labourers have been laid off, swelling the peripheries of the cities in a desperate search for work.

The continuing slump in the price of coffee, one of Latin America's main cash crops, is spreading misery across the region. A glut, caused partly by surging production in Vietnam but also by Brazil's dramatic recovery from poor harvests in the mid-1990s, has led to two years of sliding prices, causing hardship for growers on a scale unseen for three decades.

The Association of Coffee Producing Countries, whose members account for two-thirds of world output, has tried since last year to reverse the slump with a scheme to hold back 20% of exports. The hope was that this would push the ICO composite, which reflects the price of a basket of mild arabica and cheaper robusta coffees, above 95 cents per pound. But some members struggled to find the money to pay for this retention scheme, and non-members—notably Vietnam—simply increased their exports. On September 24th, as the price scraped a new low of 40.5 cents (see chart), the scheme was abandoned.



The coffee slump also affects many African countries. But its impact is especially severe in Latin America, which accounts for 60% of world output, and where coffee has long been a big export-earner and a backbone of the rural economy (see map). To make matters worse, the slump coincides with a general economic downturn. Coffee growers are pleading for aid just when governments are cutting spending in their efforts to reduce budget deficits.

The suffering is worst in Central America, where the coffee-price collapse has coincided with drought. In Mexico, Colombia and Peru, many coffee growers have small farms, and lack easy alternatives. But even in Brazil's fertile Cerrado region, where the growers are among the world's most efficient and also now benefit from a weak currency, many are still suffering. Moacir Nunes de Castro, from Patrocinio in Minas Gerais, Brazil's biggest coffee-producing state, reckons that each 60kg (132lb) sack of beans costs him 130 *reais* ($48) to produce, but it sells for only 110 *reais*. “How can we survive?” he asks.

The question may seem odd to consumers in rich countries, who nowadays pay a small fortune for a cup of froth at trendy coffee bars. But only a tiny fraction of their money goes to the grower. In fact, the price of raw coffee has long been subject to wild swings. High prices cause a surge in planting, followed by a glut and market collapse. Efforts to boost the price through buffer stocks worked fairly well while mismatches between supply and demand were temporary. But the intervention scheme operated by the International Coffee Organisation, which includes consuming countries as well as producers, collapsed in 1989 because of the unwillingness of consumers to finance mounting stocks.

Since then, better growing techniques and the swift rise of output in Vietnam have resulted in chronic oversupply. That has caused the failure of the exporters' retention scheme this week, and has placed similar national schemes, such as that operated by Colombia's Federation of Coffee Growers, under great strain.

Mexico and some Central American producers are now proposing an alternative plan to reduce supplies instead of stockpiling them, by buying and destroying low-quality beans. This was discussed by the ICO this week. But its chances do not look good. India and Indonesia, two big producers, say they will not take part. And Brazil, by far the biggest exporter, is reluctant. Producer countries would probably have to finance the scheme, and most cannot afford to. They would like the World Bank to help; they say it financed Vietnam's coffee expansion (though in fact it played only a minor part).

A more promising approach, however, might be to boost demand, and to improve marketing. “If only all the 6 billion people on earth drank one little cup of coffee a day,” dreams Marcos Costa, another grower in Patrocinio. He has a point: if the growth rate of coffee consumption were to double to about 3% annually, matching that for soft drinks, then it would keep pace with rising production. Since consumption varies widely between countries, there is scope for expansion—even in some coffee-growing countries: a marketing campaign in Brazil in the early 1990s almost doubled consumption there. Brazilians now consume, on average, 4.5kg a year, more than twice as much as Colombians and five times as much as Mexicans. Such efforts may be helped by recent studies casting doubt on the conventional view that coffee is bad for health.

Coffee growers also need to persuade consumers to pay more for quality—and to capture a bigger share of the final price of a cup of coffee. One model is Colombia: by investing in technical advice, quality control and branding, its Coffee Growers' Federation has ensured that Colombian coffee attracts a premium of 10 cents a pound over other arabica coffees. Costa Rica commands a smaller premium. A second model is Jamaica, which achieves high prices for its branded Blue Mountain beans. Even in

Colombia, some producers are now trying to secure a higher premium by marketing “single-estate” coffee, following the example of fine wine.

Growers across Latin America are now trying to copy such successes, and in some places aid agencies are helping to market “organic” or “fair-trade” coffee. A Brazilian growers' group is marketing top-quality beans under the Café do Cerrado brand. Cans of chilled Cerrado coffee can now be bought in convenience stores in Japan. Selling a brand rather than a commodity has helped the group to by-pass middlemen; a Japanese roaster buys the beans directly for twice the bulk-market price.

Brazil's government would like its coffee industry to go further still: instead of seeing exporters selling mainly green beans to foreign roasters, it wants Brazil to become a big producer of processed coffee, and will soon launch a subsidy scheme for new roasting plants. To Brazil's annoyance, some consuming countries protect their coffee-processing industries with tariffs on imports of instant coffee. But roast and ground beans do not face such barriers. Creating the right products and marketing them well could bring rewards.

Not all growers can produce single-estate coffee, nor will all consumers want to pay for it. Many farmers will have to seek other crops. Those with small plots may move to subsistence farming. But other opportunities exist. World demand for meat and fruit is rising, and Latin America has plenty of scope to supply these.

In the Brazilian state of Minas Gerais, pig farming is expanding, helped by government loans. In Patrocinio, the local council has helped growers like Mr Castro to start producing passion fruit. But there are pitfalls. A sudden cornucopia of passion fruit last year overwhelmed the local market and sent prices plunging. And export markets are often protected by tariffs, quotas or tough sanitary standards.

Coffee enjoys booms as well as busts, and it will continue to be a main source of income for many of the region's farmers. Improved marketing and diversification could reduce the pain of future slumps. But they take time. Meanwhile, the coffee bust is bringing misery to millions, with little sign of recovery in sight.

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Brazil's economy

The big squeeze

Sep 27th 2001 | SAO PAULO
From The Economist print edition

A weaker currency is only one sign of Brazil's quickening adjustment to harsher economic circumstances

SIX months ago, Brazil's economy seemed to be growing too fast. There were worries that surging demand might stoke inflation. But it has been downhill ever since. Industrial production has fallen each month since March, meaning that the country is probably now in recession. This week the IMF cut its previous growth forecast for Brazil in half, saying that GDP would expand by just 2.2% this year.

To make matters worse, the *real*, Brazil's currency, has continued to weaken (see chart). It is the victim of a vicious circle of declining confidence. Apart from a home-grown energy shortage and uncertainty about the outcome of next year's presidential election, Brazil and its currency have been hit by outside events—notably Argentina's troubles and investors' flight to safer assets after September 11th.

This poses policy dilemmas for the government. Despite the slowdown, the weak *real* has increased the price of imports, meaning that inflation this year is likely to be higher than the Central Bank's target of 6%. The bank has tried to prop up the currency with higher interest rates, sales of dollars from its reserves and auctions of dollar-linked bonds. But since most of the government's debt is linked either to interest rates or to the dollar, the combination of rising borrowing rates and a weakening currency has bumped up the debt total, making markets more nervous still.

On September 21st, despite the Central Bank's sale of a further $1.7 billion of dollar-linked bonds to halt the currency's slide, it fell a further 3% to a new low of 2.84 *reais* to the dollar, taking the fall in its value this year to 31%. That prompted a change in tactics. The Central Bank announced an increase in banks' compulsory deposits and President Fernando Henrique Cardoso called an “emergency” ministerial meeting on September 24th. That sparked fears of a reintroduction of exchange controls. Instead, officials decided merely to create a task-force to try to boost exports.

These measures mean that the government knows that a balance-of-payments crisis is round the corner, says Marcelo Carvalho of J.P. Morgan Chase, an American investment bank. Foreign direct investment is falling: in the first eight months of this year, it totalled $14 billion, down from $21 billion in the same period last year. Since Brazil has relied on foreign direct investment to cover its current-account gap, which has been running at 4-5% of GDP, this gap must now be made to shrink.

Boosting exports takes time, and will be tough during a world economic slowdown. So much of the adjustment will have to come from lower imports—in other words, recession. The increase in banks' compulsory deposits will squeeze credit. This is a less visible way of depressing demand than a further increase in interest rates, and one that also avoids cranking up the government's debt.

So far Brazilian consumers have not felt the squeeze. Real wages have fallen slightly but unemployment has not yet risen. With output falling, loans becoming scarcer and the cost of living set to rise, they should soon get the picture.

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The United States and Latin America

Together, for now

Sep 27th 2001
From The Economist print edition

Unity conceals new tensions

FOR the first time since the 1960s, the Rio treaty, a cold-war mutual-defence pact for the Americas, has been invoked, this time in support of the United States' campaign against terrorism. At a meeting in Washington on September 22nd, the region's foreign ministers pledged to co-operate in tracking down and extraditing terrorists. But behind this façade of unity, Latin America's solidarity is strained.

The decision to invoke the treaty came at Brazil's initiative, and was approved unanimously. But only just. President Hugo Chavez of Venezuela, who last year visited Iraq and is due in Libya next month, was persuaded to fall into line only at the last minute, by President Fernando Henrique Cardoso of Brazil.

The American campaign against terrorism is causing awful difficulties for Mexico. During a state visit to Washington before the attacks, Vicente Fox, Mexico's president, had criticised the Rio treaty as “obsolete and useless”. Now Jorge Castañeda, its foreign minister, is being lambasted at home for supporting the United States' right to “revenge”.

Latin America will no doubt do its best to comply with the American request to tighten controls on borders and terrorists' finances. But rather to the surprise of American officials, the attacks have laid bare the continuing strength of anti-American opinion in the region. Governments are “going to have to find a way to balance their foreign-policy concern to support the United States against public opinion that could become increasingly hostile once conflict begins,” says Peter Hakim of the Inter-American Dialogue, a Washington think-tank.

To make matters worse, Latin America's main economies are sinking into recession, amid widespread disillusion with the meagre fruits of a decade of American-backed free-marketry. “It all points to a far rockier period for relations between the United States and Latin America,” according to Mr Hakim.

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Terrorism in Argentina

Bombed

Sep 27th 2001 | BUENOS AIRES
From The Economist print edition

Exposing the flaws of the state

Reuters

Seven years on, and still no answers

IN 1994, in the most serious criminal attack in Argentina's history, a bomb demolished a Jewish welfare centre in Buenos Aires, killing over 80 people and injuring at least 250. Intelligence sources believe that the bomb was the work of Hizbullah, a Lebanese-based terrorist group with Iranian and Syrian backing. But the trial that opened this week of 20 men accused of involvement in the attack may throw more light on the shortcomings of Argentina's police and judiciary than on the workings of Middle Eastern terrorism.

Those in court are alleged to be no more than the local connection—a motley assortment, asserts the prosecution, of small-time crooks and bent policemen. They are accused of supplying a van that was later filled with explosives and detonated outside the welfare centre. Argentina's press has long asserted that terrorist cells operated from Ciudad del Este, a smuggling centre on Paraguay's border with Argentina which has many traders of Middle Eastern origin. But this has not been reliably established by Juan Jose Galeano, the investigating judge. In fact, Mr Galeano has established remarkably little. He has not determined whether the attack was carried out by a suicide-bomber, nor even the precise death toll.

“Despite 375 volumes of evidence, we basically know no more now than a week after the attack,” complains Alberto Luis Zuppi, a lawyer for the families. He says important evidence has been lost or destroyed, and accuses Mr Galeano not just of incompetence, but of misconduct. In a videotape that has surfaced publicly, Mr Galeano is seen offering $450,000 and a book contract to one of the main defendants in return for implicating several rogue policemen in his testimony. Mr Galeano denies any wrongdoing.

This week, the victims' families filed a request for Mr Galeano's removal. But the accusations go further. Another judge is investigating claims by a former court official that SIDE, the state intelligence service, failed to act on prior information of the attack. Intelligence sources deny this claim. They blame the failure of the investigation on the lack of resources, technical skill and sophistication of Argentina's intelligence services. They point out that records of those entering and leaving the country are incomplete and not computerised.

Certainly, the security services had reason to be alert. In 1992, a bomb at the Israeli embassy in Buenos Aires killed 29. SIDE has launched its own inquiry, whose results may eventually be passed to the court. Both sides hope that the trial will produce new information. But the perpetrators are now unlikely to be caught. Although there is no proven link with the attacks on New York and Washington, “impunity for those who carried out this attack paved the way for other bigger attacks elsewhere,” argues Mr Zuppi.

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Bangladesh's election

A vote for bin Laden?

Sep 27th 2001 | DHAKA
From The Economist print edition

EPA

The intruder in a violent election campaign

Get article background

POSTERS in support of Osama bin Laden are competing for wall-space among those of the official candidates in Bangladesh's general-election campaign. But who would want to be associated with him? No respectable politician, surely. The caretaker government that has been running the country during the election period has assured the United States of its support, even offering the use of its airfields. Both the main parties, the previously governing Awami League and the Bangladesh Nationalist Party (BNP), have said they are solidly against terrorism. Everyone has been shocked that at least 50 Bangladeshis appear to have died in the attacks on the World Trade Centre in New York on September 11th.

Yet among the 127m people in this overwhelmingly Muslim country it is inevitable that some do not share the official line. An Islamic political party, the Jamaat-i-Islami, formally condemns terrorism, but "suggests" that the United States should try to identify "the real culprits" before taking any action. The Awami League, fighting for re-election on October 1st in what is predicted to be a close vote, says the BNP has allied itself to two hardline Muslim parties, and that if it wins the country will lose its secular nature. The League fervently hopes that any attacks on Afghanistan, where Mr bin Laden is believed to be hiding, will take place after the election. Should they come earlier, a nervous nation might, however irrationally, blame the previous ruling party. Any attack could provoke uncontrollable demonstrations in favour of Mr bin Laden, interfering with orderly voting. Already anti-American demonstrations have been held in Dhaka.

The election campaign is being given much less prominence in the country's newspapers than the events in Afghanistan and in Pakistan—of which Bangladesh was a part until it broke away in 1971. But the "terror" debate has at least introduced a moral element into a campaign otherwise dominated by the mutual antipathy of Sheikh Hasina of the Awami League and Khaleda Zia of the BNP. The two leading ladies appear more interested in trading ever more vitriolic insults than in holding a serious exchange. Each has accused the other of carrying out violent attacks against her political opponents and both have produced X-rated video evidence depicting blood-spattered victims to support their case.

It has indeed been a violent campaign. So far more than 100 people have died, among them ten in a bomb explosion at a political rally in Bagerhat, in south-west Bangladesh. No party admitted responsibility. Officials said "Islamic radicals" might have carried out the attack. The caretaker government, under pressure to ensure that the vote for the 300 seats in parliament is free and fair, has deployed over 50,000 troops to keep the peace. At the start of the campaign it said it would take the gun

out of Bangladeshi politics, but armed Awami League and BNP supporters are to be seen everywhere.

Indeed, such issues as have been ventilated in the campaign have revolved around the problem of violence. The BNP claims that the Awami League government failed to provide law and order. Most Bangladeshis say violent crime is on the increase, and the Awami League has privately conceded that it has failed to combat the problem successfully. The election itself was preceded by a series of general strikes, some of them violent.

Nevertheless, Sheikh Hasina claims that she has done well: that she has improved relations with India, ended an insurrection staged by tribal rebels in the Chittagong Hill Tracts of the south-west, and overseen a period of sustained economic growth. The economy grew by 5.9% last year and the rate is predicted to rise to 6.1% in 2001-02. Agriculture, the main employer, is prospering, although not enough to provide all the jobs required by a rapidly expanding population. Bangladesh needs more foreign investment. But that is tied to the promise of stability, far from certain in Bangladesh at present.

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Japan and the fight against terrorism

Uncharted waters

Sep 27th 2001 | TOKYO
From The Economist print edition

Koizumi reassures Bush

AP

THEY will not look especially potent, bobbing alongside the assembled might of the United States' navy. But the destroyer, supply boat and two escort ships that Japan's defence agency is itching to dispatch to the Indian Ocean are already making big waves at home. For the first time since the second world war, Japanese forces could end up serving in a war zone. New laws will be needed, and perhaps a new interpretation of Japan's constitution, which renounces war.

Both topics are encouraging a lively, and long overdue, public debate. One surprise is the big shift in public opinion. During the Gulf war ten years ago, most Japanese shrank from sending troops to the Middle East. But a poll by the *Nikkei* newspaper finds that more than two in three favoured providing logistical support for American forces this time. Visiting Washington this week to pledge military support, Junichiro Koizumi, the prime minister, spoke of Japan's shared “strong anger” at the terrorist attacks, an unusually forceful phrasing for a Japanese leader.

Conservatives have wasted no time capitalising on the public mood. The Japanese must help their American allies, thundered the right-wing *Yomiuri* newspaper, and not just with “tea and biscuits”. Part of this reflects the nature of the enemy. Not even Japan can afford to think of itself as safely isolated from the threat of international terrorism. Shortly before the strikes on New York and Washington, America had given a warning of a possible attack on its military bases in East Asia.

Japan is host to more than 40,000 American troops. Intelligence reports suggest that a dozen or more associates of Osama bin Laden entered Japan in early September. Japanese security forces are said to be investigating the abandoned offices of a second-hand car dealership in Saitama prefecture, which had shipped cars to Pakistan and Afghanistan. Terrorists may have profited in Japan's financial markets. This campaign feels uncomfortably close to home.

Yet Japan's self-defence forces find themselves as hopelessly ill-equipped to protect the homeland as they do to wage war abroad. Without an explicit order from the prime minister, Japanese troops are not allowed to guard the prime minister's residence, nuclear power stations, American military bases or a host of other likely terrorist targets. Stranger still, Japan cannot impose martial law. Were the country to be overrun by terrorists or even an invading army, Japanese tanks would still be obliged to stop at red lights and ask permission to park on private property.

Some of these rules about home defence look certain to change. There is more caution about sending troops abroad. If he plays it safe, Mr Koizumi will bring in a law that allows the rules to be relaxed only temporarily. But the prime minister has begun to hint at something more ambitious. This would be struck not within the inhibiting embrace of coalition government, but with the co-operation of the opposition Democratic Party, which favours a bigger role abroad for Japan's forces. The voters seem ready for it. Their support will give Mr Koizumi encouragement.

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Indonesia

Treading warily

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As confrontation looms, Indonesia is a nervous spectator

THE world's most populous Muslim nation; its third-largest democracy; home to the second head of state received by George Bush after September 11th: Indonesia ranked high in American diplomatic priorities after the terrorist onslaught. But the importance of Indonesian solidarity against terrorism must be weighed against the danger of an Islamic backlash at home.

On a small scale, that has already happened. Since Megawati Sukarnoputri, the president, met Mr Bush in Washington on September 19th, anti-American demonstrations have been held in several cities. On September 23rd groups of Muslim men scoured hotels in Solo, in Java, in an unavailing hunt for Americans. More than 200 young men were reported to have volunteered to fight in Afghanistan.

None of this represents more than the actions of an extremist fringe. Some 85% of Indonesia's 212m people call themselves Muslim. But most practise a moderate and syncretic form of Islam. Most will ignore, or interpret loosely, a call on September 25th by Indonesia's top Islamic authority, the Council of Ulemas, to wage a *jihad* (struggle) if America attacks Afghanistan.

Miss Megawati, a nationalist who represents the moderate majority, has condemned the attacks on the United States as “the worst atrocity ever inflicted in the history of civilisation”. In Washington she was grateful for all the financial help suddenly coming her government's way. But her backing for America was understandably muted. In the parliament resulting from an election in 1999, nearly 35% of the seats are held by Islamic parties. In recognition of this, Miss Megawati's vice-president is Hamzah Haz, the leader of the largest of them. He too has condemned the attacks on America, but he has also caused offence by hoping aloud that they would “cleanse the sins of the United States”.

Miss Megawati has been in office for only two months, put there by a parliamentary rebellion against her predecessor, Abdurrahman Wahid. If the Muslim parties think they can portray her as an American stooge, they may also believe that lightning can strike twice.

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Political power in India

Jayalalitha's setback

Sep 27th 2001 | DELHI
From The Economist print edition

But though the Supreme Court resists her charms, she remains powerful

RUNNING state governments in India by remote control is becoming a habit. Jayaram Jayalalitha, a controversial film star turned politician, nominated O. Panneerselvam, a novice politician, to succeed her as chief minister of Tamil Nadu when she had to leave the job on September 21st. He duly touched Miss Jayalalitha's feet and declared his appointment was an arrangement only until she returned to power.

In Bihar, Laloo Prasad Yadav was succeeded four years ago as chief minister by his wife, Rabri Devi, when political pressure arising from corruption charges forced him to give up the job. In Maharashtra, Bal Thackeray, boss of the chauvinist Shiv Sena, steered his party to a victory in 1995 without himself standing for office, and then dubbed himself Mr Remote Control. Miss Jayalalitha, however, outclasses the other two in terms of arrogance. She entered politics after the death of her lover, a former chief minister who had also been a film star. She became chief minister of Tamil Nadu in 1991, but was not re-elected in 1996. Because of a subsequent conviction for corruption, she was barred from standing as a candidate in the state elections last May. But her party won handsomely and she was sworn in as chief minister. It was claimed that she was eligible for the job because the courts had set aside a three-year jail sentence for corruption pending an appeal.

The Supreme Court has now accepted a claim that she was ineligible for office because only her jail sentence, and not her conviction, had been set aside. Miss Jayalalitha, however, still wields power by remote control.

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Village elections in China

A taste of democracy

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From The Economist print edition

And it turned sour

Reuters

But are they secret?

TO THE residents of Daling, a village in Hebei province, elections have brought nothing but misery. For opposing the officially approved candidates in the village council polls held seven years ago, dozens have endured beatings and threats by police and thugs. Some have toured the offices of the government and the Communist Party as distant as Beijing, 180km (112 miles) away, to seek the democratic rights they should enjoy by law. Despite an unusual intervention by the Politburo, they remain angry.

Though hailed by some in the West as a breakthrough in China's glacial rush to political reform, the introduction of direct elections in China's 800,000 villages since the late 1980s has done little to show off the merits of democracy. The problems faced by Daling's 3,800 villagers illustrate how, in many places, the elections have exacerbated tensions between various tiers of rural administration. The polls are often rigged and the committees elected simply pawns of higher-level government. Some Chinese academics believe the peasants are losing interest in the elections.

Daling's inhabitants had their one and only taste of democracy in 1994. In line with a practice then being encouraged in China—though not actually required until the late 1990s—the villagers were supposed to elect their leaders directly by secret ballot. But it was Daling's Communist Party committee that decided whose names should appear on the ballot. The man most admired by the villagers, but disliked by the party secretary, was not among them. When nearly 1,100 villagers wrote his name, Feng Zhishui, on their ballot slips anyway (more than 50% of those who voted), local officials refused to recognise his victory.

According to villagers, county leaders dispatched a team to the village. They knew who had supported Mr Feng because officials had illegally marked the ballot papers. The team rounded up more than 100 of Mr Feng's backers and accused them of disrupting the elections. Eleven were said to have been beaten by the police. Some were tortured with electric batons. Some were handcuffed, or forced to adopt painful positions for long periods. Mr Feng's father was expelled from the party after more than 50 years' membership. Family members say Mr Feng's younger brother was arrested, tortured and sentenced to nine years in jail on trumped up corruption charges. Mr Feng himself fled, but was caught in 1998 and jailed for seven years, accused of embezzlement.

Mr Feng's supporters petitioned officials from the county level right the way up to the central party leadership in Beijing. They also wrote to the state-run news agency Xinhua, which submitted a secret report to the leadership. Early last year the Politburo ordered the Hebei provincial authorities to investigate. The results were mixed. Mr Feng's father got his party membership back, Mr Feng's sentence was reduced to three years and his brother was released. The unpopular party chief of Daling was replaced, but with one of his cronies. Villagers are not optimistic that Mr Feng will be allowed to serve as chief or that free elections will be held in future.

The Chinese government recognises that problems with the election system abound. And it has not set its sights high. Its target was to ensure that a mere 15% of China's villages could be described as successful practitioners of the new system by the end of 2000. In a book published in China last year, Cheng Tongshun of Nankai University estimated that over 60% of elected village committees did little more than carry out the orders of higher-level (unelected) governments. A government researcher, Zhao

Shukai, wrote this year in the official journal *Key Economic Reference* that, despite the elections, rural administration still worked much as it had under the centralised, and disastrous, “people's communes” of Mao Zedong.

What has gone wrong? A glaring deficiency is that the powers of the elected committees relative to those of local party committees or higher-level rural governments are too vaguely defined. Elected officials often struggle with appointed party secretaries for control of a village. Fearful of losing its grip entirely over villages or of provoking peasant unrest, the party is reluctant to make clear who is in charge. The result is administrative paralysis and mounting frustration among peasants.

For their part, township governments, which are responsible for several villages, believe that whoever is in charge should be subordinate to them. This means elected officials have to spend much of their time implementing highly unpopular directives to squeeze peasants for more taxes, say, or to prevent them from exceeding birth quotas. A possible remedy—directly electing township chiefs as well—has been tried in one or two places, but the central leadership is afraid of allowing that idea to spread lest it trigger more sweeping demands for democratic change.

Another problem is that Chinese peasants have no democratic tradition. As they have been for centuries, many are deeply loyal to patriarchal clans. They will often vote not for who will lead them best, but for their senior clan leader. In richer areas, the rich simply buy votes. “In some areas, peasants are even more dissatisfied with their officials than they were before elections,” says Mr Zhao, the official researcher. Petitions and violent clashes with officials are becoming common.

When village elections were introduced, Peng Zhen, then head of China's parliament, described them as a training class for democracy, and suggested they could be gradually extended to higher levels of government. But if they do not work in villages where electorates are tiny and everyone knows everyone else, how much more difficult would they be to organise in larger communities? The experience with village elections so far may simply have reinforced the common view among Chinese officials that political change could lead to chaos.

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Israel and the Palestinians

The beginning of the end of the Palestinian uprising?

Sep 27th 2001 | JERUSALEM
From The Economist print edition

Sadly, one meeting does not spell peace. It will take a lot more American pressure to end the intifada

Reuters

Get article background

AFTER a year of bloody fighting, but with neither side beaten, Israel and the Palestinians are finding it hard suddenly to stop shooting and start talking again. They may have to, though, if the United States keeps up its pressure on Ariel Sharon and Yasser Arafat to take themselves and their pesky dispute off the international agenda while America makes world war on terrorism. This week, after a barrage of telephone calls from Colin Powell, America's secretary of state, Mr Sharon had to drop his demand for 48 hours of no Palestinian violence before he allowed his foreign minister, Shimon Peres, to meet Mr Arafat and discuss a ceasefire.

The meeting duly took place on September 26th, at the Palestinian airport in the Gaza strip. If the fragile ceasefire survives, another meeting will be held “within a week or so”, and later a third. By then, the two men may be discussing the report compiled earlier this year by a group of international statesmen under George Mitchell, a former American senator, which recommends, among other things, a freeze on Israeli settlement-building.

Few Israelis believe that things will go so well. Mr Sharon predicts openly that Mr Arafat (“our bin Laden”) will not curb all the violence (he “has not forsworn his strategy of terror”), though the prime minister conceded this week that the Palestinian leader had taken some effective measures to prevent more bombings. The Israeli left suspects the prime minister of being reluctant to get into real peace talks, and that he therefore does not want the current detente to succeed.

Mr Sharon, riding high in the opinion polls, is less concerned about the ragged left than about the increasingly strident attacks on him from the hardline right, the mainstay of his support. Marshalled by Binyamin Netanyahu, a former and would-be-future prime minister, right-wing critics say that Mr Sharon, softened by Mr Peres's Delilah-like charms, is frittering away the unique opportunity, created as they believe on September 11th, of winning the *intifada*.

Far from ending the fight, they say, Israel ought to be intensifying it. But, says Mr Netanyahu, Mr Sharon is kowtowing to the pro-Arab State Department, which anyway does not reflect mainstream American thinking now. Feeling the heat, Mr Sharon's aides have warned the Palestinians that if their attacks continue despite the Arafat-Peres meeting, Israel will quickly resume its “military initiatives”.

Mr Arafat, for his part, is acutely aware that part of the Israeli government sees the carnage in America as a chance to bury the *intifada*, his regime and perhaps himself for good. Not only does he hear what Mr Sharon says about him but, in the week after September 11th, the Israeli army killed 28 Palestinians and mounted 16 incursions into Palestinian Authority areas. Mr Arafat's frightened answer was to declare a ceasefire “on all fronts” and express readiness to enlist in America's coalition for “ending terrorism against unarmed innocent civilians”. This sharply reduced (but did not end) Palestinian violence.

Mr Arafat warned the Palestinian “forces”—fighters belonging mainly to his Fatah faction and to the Islamist Hamas and Islamic Jihad movements—not to give “pretexts” that would aid Mr Sharon's designs. They heeded his counsel, partially. Though they agreed to end attacks on civilians in Israel and firing on

Jewish settlements from Palestinian-controlled areas, they did not agree to end armed actions in defence of Palestinian towns and villages still under occupation. They also said they would “respond” if Israel acted against them or their people.

On September 24th the Israeli army established a 32km (20-mile) “closed military zone” along the West Bank's northern border with Israel. This, says Israel, is to prevent suicide bombers from infiltrating its cities. The Palestinians say it is a de facto annexation that puts 24,000 Palestinians under direct Israeli rule, within a web of apartheid-like pass laws. The same day an Israeli woman was killed in an ambush in the Jordan valley. Islamic Jihad claimed responsibility, saying it no longer felt bound by the ceasefire.

The fact that Mr Arafat was obliged to accommodate his ceasefire to the factions' conditions is one sign of the changes the *intifada* has wrought in the Palestinian national movement, with power now divided between the militias and the leader. It is a shift cemented by the support the *intifada* still commands among Palestinians, with a colossal 85% wishing its continuation, according to a recent Palestinian poll.

This level of support is remarkable. Now at its first anniversary, the *intifada* would seem a litany of Palestinian losses. The Israelis have suffered greatly, with nearly 170 of their people killed during the year. But the Palestinians have seen more than 600 of their people killed and 15,000 injured. And the Palestinian economy and psyche have been devastated.

But most Palestinians never viewed the uprising as a deliberate act of revolt. It grew rather as an ad hoc, untidy resistance to what they considered Israel's attempt to impose militarily what it had failed to impose diplomatically at the Camp David summit last year: a solution on Israel's terms. If Mr Arafat is now signalling an exit from the *intifada* and so a departure from the Palestinian consensus still behind it, he will need more than a ceasefire from Mr Peres. He is looking for steps that will improve Palestinians' lives, and give them renewed hope in a political process that will one day meet their national aspirations. Without such movement, and the continuing American pressure to bring it about, the *intifada* is likely to be rekindled.

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Iraqi Kurdistan

Bandwagon

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From The Economist print edition

The Kurds climb on it

IN THE not-so-safe haven of northern Iraq, Jalal Talabani, a Kurdish militia leader, has launched an assault on his former ally, the Islamic Movement of Kurdistan (IMK), and its enclave close to the Iran-Iraq border. This week Mr Talabani's Patriotic Union of Kurdistan (PUK) stormed the ill-fated town of Halabja, to oust the IMK from the place that has been its base for seven years. The PUK, which is said to have lost 100 fighters, is presenting the takeover as a victory in the war on terror.

Within hours of the September 11th attacks on America, the group's websites accused the IMK and its hardline offshoot, Jund al-Islam (Army of Islam), of receiving training and money from al-Qaeda and, for good measure, Iraqi intelligence agents. They were planning, says the PUK, to create a haven within a haven for Osama bin Laden.

Poppycock, says the IMK, perhaps the third-strongest of the Kurdish militias. Inspired by the Afghan *jihad* (struggle) against the Soviet Union, its own *jihad* against Saddam Hussein dates back to the 1980s (Saddam responded by dropping chemical weapons on Halabja). The IMK admits a few of its fighters are veterans of the Afghan war. But it says it has repeatedly refused to offer Arab *afghanis* a refuge, for fear of jeopardising its warm relations with America and Saudi Arabia.

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Iran and Britain

Ambiguity, at best

Sep 27th 2001 | TEHRAN
From The Economist print edition

No certainty about the way Iran would respond to an attack on Afghanistan

JACK STRAW, the most senior British minister to have visited Iran since the 1979 Islamic revolution, praised Iran's leaders for their prompt condemnation of the September 11th attacks. But in his talks with President Muhammad Khatami and Kamal Kharrazi, Iran's foreign minister, in Tehran on September 25th, Britain's foreign secretary did not get what he had come for: Iran's private acquiescence to a retaliatory offensive against Afghanistan. Much as it loathes the Sunni Muslim Taliban, Iran's Shia Muslim republic could hardly team up with America, an old foe it accuses of sponsoring Israeli “terrorism” against Palestinians, to take Muslim lives.

There were, however, some encouraging signs. Until Mr Straw's visit, Iranian leaders had demanded that such an offensive should be run by the United Nations, and not the United States. At his press conference on Tuesday, Mr Kharrazi helpfully dodged a question about the need for increased UN involvement. Instead, with studied ambiguity, he called for an “international consensus”. Ayatollah Ali Khamenei, Iran's fiercely anti-American supreme leader, decreed this week that America's war on terrorism was not “sincere”.

Iran, as Mr Straw seductively recalled, has an interest in a “change in governance” in Afghanistan. Nothing would please Iran more than to see a new regime, particularly one whose composition it could influence. It calculates that it would then be able to negotiate the return of the more than 1.5m Afghan refugees it currently lodges at heavy social and financial cost. It might also be able to staunch the supply of cheap opium and heroin that has made addicts of more than 2m Iranians. By godfathering Afghanistan's Shia minority, which the Taliban have treated horribly, it might counter the influence that Russia and Pakistan will hope to exert.

For all that, if an attack comes, Iran could well respond with two voices. Senior conservatives have already said that they oppose American retaliatory action. In particular, they would like to scotch reformist hopes that co-operation might bring collateral advantage in the form of an improvement in relations with America. Whatever the mutual goodwill, Mr Straw may well have left Tehran unsure whether Iran will greet an attack with obliging silence, or a denunciation that dents the coalition's fragile ecumenism.

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AIDS in South Africa

Heads in the sand

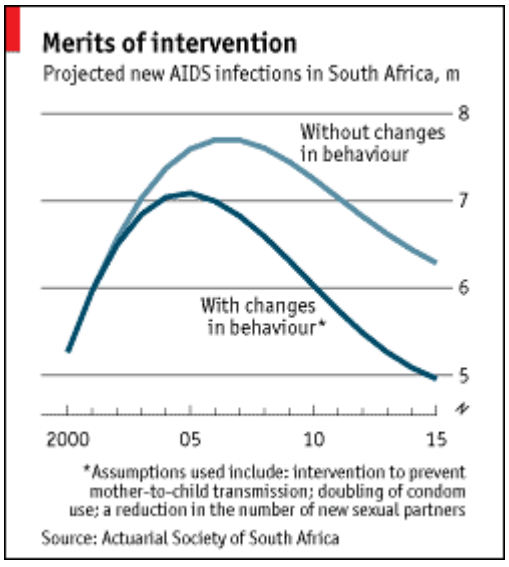
Sep 27th 2001 | CAPE TOWN
From The Economist print edition

When will South Africa's government acknowledge the size of the problem?

AP

"WHAT is distressing is that we really are fiddling while our Rome is burning...people are dying, but unpleasant truths we tend to deny." Last week Desmond Tutu, a retired archbishop, head of the Truth and Reconciliation Commission and one of the most respected men in South Africa, added his voice to the chorus lamenting the government's failure to tackle the country's tragic AIDS epidemic.

Mr Tutu's appeal—he wants anti-retroviral drugs for all who need them, open talk about sex and condoms, and the declaration of a national emergency—should have some impact. Nagging from newspapers, foreigners and the opposition leaves the government unmoved. But Mr Tutu is widely loved. Moreover, his cry for action was delivered in unison with a coalition of church leaders, the main trade-union grouping (COSATU, which is an ally of the ruling party and other activists who want the policy on AIDS rethought.



The government not only keeps its head deep in the sand, but it is also trying to bury the latest report on mortality rates in South Africa. This five-year study, not yet officially released, has been produced by the Medical Research Council (MRC), a serious body that gets two-thirds of its money from the government. It gives the most authoritative picture yet of the impact of the disease. Leaked copies confirm the gloomy analyses made by other researchers: 40% of adult deaths and a quarter of all deaths last year were AIDS-related; between 4m and 7m people will die of the disease within a decade; life expectancy will plummet (another report recently suggested it could go as low as 41 years) if nothing more is done.

Such dire predictions are neither new nor controversial. But they sharply contradict recent statements by President Thabo Mbeki. Last month Mr Mbeki claimed that "external causes", such as car crashes and criminal violence, were the biggest killers in South Africa, and that AIDS accounted for only a small fraction of the total. In a letter to his health minister, he used 1995 figures from the World Health Organisation to bolster his case. The WHO responded angrily by pointing to current estimates which show that 250,000 people die of AIDS each year in South Africa. This makes it the leading killer.

The government clumsily postponed the report's release. On September 21st, at the last minute, the MRC's president, Malegapuru William Makgoba, cancelled the presentation of it to Parliament. At his Cape Town offices, he claimed to possess not a single copy. Though the MRC calls for the facts to be heard as soon as possible, officials are now talking of the need to go through proper bureaucratic procedure before releasing the statistics.

Road to disaster

Mr Mbeki's attitude, say his critics, is discouraging others from taking effective action, whether it be undergoing HIV tests or changing sexual behaviour. Tony Leon, leader of the opposition Democratic Alliance, puts it bluntly: “Every week we have the equivalent number of people dying from AIDS as died in the World Trade Centre bombing. But our president denies the pervasiveness, the cause and the treatment of AIDS.” Even the health ministry, which in public keeps steadfast with the president, has given a warning, in an internal memorandum leaked last week, that the government's AIDS policy is “politically dangerous” and “unacceptable from a human-rights perspective”.

Working on the assumption that one in ten of all South Africans is infected with HIV, the memorandum concedes that spending is so inadequate that the poor get “substandard” attention. Care is so inequitable that legal and political challenges should be expected. Already one activist group has taken the government to court over its refusal to give drugs to pregnant women with HIV, which would protect their babies from infection.

Yet last month Mr Mbeki seemed to suggest in his letter to the health minister that she should consider cutting money for AIDS care. Though spending on public health grew by an impressive average of 9% a year throughout most of the 1990s, the AIDS epidemic means that vastly more needs to be spent just to keep hospital and other care at current standards. The government has had some successes: for instance, the incidence of syphilis has dropped by 80% in the past eight years. But it cries off giving anti-AIDS drugs to prolong lives and reduce infection.

The government's argument is that these drugs are far too costly. But this excuse may not be tolerated for much longer. South Africa's neighbour, Botswana, has announced that drugs of this sort will be free. And since the South African government won a court case against the pharmaceutical companies earlier this year, bringing down the price of these drugs, treatment should be more affordable, even if the country's poor health services mean that they cannot be distributed to everyone who needs them. Already, in parts of the country where the opposition runs local government, drugs have been made available. Will such examples, and the appeals from Mr Tutu and other prominent people, persuade the stubborn Mr Mbeki at least to concede the size of the problem that his country now faces?

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Landmines

Curbing horror

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From The Economist print edition

Efforts to rid the world of landmines are just beginning to pay off

A COUPLE of months ago, Blanca Nubia Chamorro, aged 12, found a ball in her village in southern Nicaragua. As she was playing, it blew up. Blanca now lies in hospital without her left arm and right hand.

Years after all fighting has stopped, landmines continue to cripple people in countries that have known savage wars, including Nicaragua, Cambodia and Mozambique. Afghanistan, where new fighting is now awaited, may still be the most heavily mined area in the world. Moreover, the vile contraptions continue to be planted by governments or rebels in some 25 countries. According to the International Campaign to Ban Landmines (ICBL), mines claim well over 15,000 victims a year in about 90 countries.

At least matters are not as bad as they were. As they got together in Nicaragua on September 18th, the parties to the 1997 Ottawa convention—which bans the use, production, stockpiling, sale and purchase of landmines—had cause for congratulation. The ICBL was able to report that 185m square metres (46,000 acres) of mined territory was cleared last year; the number of producers has shrunk from 55 to 14 over the past few years; trade seems to have come to a halt; stockpiles are shrinking, with 27m mines destroyed; the number of new victims, while still high, is declining. There are now 120 full members of the convention, with another 21 on the way.

Yet 240m landmines are still thought to be stockpiled in about 100 countries. The Ottawa convention requires members to clean up their arsenals within four years, but nearly 20 countries have not even started to do so. More to the point, most of the world's landmines are held by countries that have declined to sign the treaty. China alone is sitting on 110m landmines, almost half the total stockpile. Russia and America, two other determined non-joiners, have stockpiles estimated at 65m and 11m respectively.

How to get them to obey

Getting members to stick to their obligations is tricky. Uganda is said to be producing landmines in a government factory, and to have used them during the war in Congo. The ICBL believes that Tajikistan, another member, has allowed Russian troops to lay landmines on its border with Afghanistan. Angola, which has signed but not yet ratified the treaty, openly admits to using mines. Ethiopia, Sudan, Rwanda and Burundi, also signatories, are suspected of foul play, although they all firmly deny it.

Theoretically, the Ottawa convention is legally binding, but identifying the culprits, let alone enforcing the law, is not easy. Many members have not yet provided clear information about their landmines, an obligation under the convention. Monitoring what is happening to the mines is difficult and time-consuming and is not part of the convention: most of the work is carried out by the ICBL's 115 researchers. And even when countries are found guilty, bringing them back into line depends on peer pressure, since no clear penalty system has been devised.

Another troubling point is that the convention binds only governments. Yet landmines are a weapon of choice for rebels. The Nicaraguan meeting acknowledged that insurgents too should give them up. But it will take much more than peer pressure to get them to do so.

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Poland's election

The left is back—in the centre

Sep 27th 2001 | WARSAW
From The Economist print edition

Communists turned social democrats have triumphed in Poland's general election—but populists and the far right have become a worryingly large minority

Get article background

AP

IT IS a pattern that has become common in Central Europe: the repackaged communists are back. At first glance, the results of Poland's general election on September 23rd would seem to mark a dramatic reversion to the communist past and a sullen rejection of the market reforms of the past decade. In fact, Poland has a steadier government, now centre-left and not communist at all, which should be better able than its ramshackle predecessor to bring the country into the European Union, still the top priority of all Poland's main parties.

The ex-communists, now called the Democratic Left Alliance, took 41% of the vote on Sunday. In contrast, Jerzy Buzek's outgoing government, based on the once-heroically anti-communist Solidarity trade-union movement, took less than 6%, failing to win even a single seat in parliament. Bronislaw Geremek's economic liberals of the Freedom Union, who walked out of the coalition government a year ago, were also butchered: with 3% of the vote, they too have lost all their seats. Turnout was a dismal 46%. The old anti-communist front that stirred hearts at home and abroad 11 years ago has been wiped out.

The end of market reform, then? Very probably not. Most of the ex-communists have genuinely changed. The incoming prime minister, Leszek Miller, a dour but wry 55-year-old ex-apparatchik (pictured above), is now pro-market, pro-NATO and pro-EU. His disappointment, despite securing the biggest electoral victory in the history of an independent Poland, is that he failed to win an outright majority of seats. He must therefore build a coalition or make a pact. That may not be easy.

The Civic Platform, under Andrzej Olechowski, which got 13% of the vote, shares many of the Democratic Left's policies but is the natural opposition in parliament. The only other party that could join the ex-communists is the Peasants' Party, which took nearly a tenth of the vote. It has been an awkward partner for the ex-communists in the past and is lukewarm in its attitude towards joining the EU.

Nationalist extremists did alarmingly well

The most worrying outcome of the election was the success of nationalist extremists. Among those seeking the protest vote, the biggest winner was a populist pig-farmer, Andrzej Lepper, and his xenophobic Samoobrona (Self-Defence) party, which won a good tenth of the vote. He says he might reluctantly support Poland's entry to the EU, but only if it gained concessions that it is unlikely to get. Tanned by nightly visits to his sun-bed, sporting an Elvis Presley-style quiff and a white-and-red tie, Mr Lepper adroitly used television to tell small farmers and former collective-farm workers that the crooked *nouveaux riches* of Warsaw had bled the country dry and that joining the EU, in its present form, would be death to Poland's countryside and those who lived in it.

He certainly drowned out the voice of the Peasants' Party, which has spoken for small farmers in the past. A few weeks ago its leader, Jaroslaw Kalinowski, sent Mr Lepper a haughty note offering him a third of the seats if he would join forces—a proposal Mr Lepper rejected with disdain.

The outgoing government alliance was beaten even by two parties of the hard right that few pundits had hitherto taken seriously. The Law and Justice Party, led by identical twins, Lech and Jaroslaw Kaczynski,

who demanded the return of the death penalty and inveighed against corruption, took nearly 10% of the vote. The other party to spring up from nowhere is the League for Polish Families, which got nearly 8%. Often anti-Semitic, it is backed by the ultra-nationalist wing of the Roman Catholic church, whose Radio Marya is said to have 4m listeners. The league has damned the EU as a “civilisation of death” for what it takes to be the EU's views on abortion and euthanasia.

Mr Miller, who campaigned on a platform of budgetary caution and austerity, has his work cut out. Unemployment is 18% and rising, economic growth has slumped from 7% a few years ago to a predicted 2% this year, an ambitious health-care reform has gone down badly, and the latest projections suggest a deficit of $5 billion in next year's budget.

Mr Miller has gone some way to reassure nervous foreigners, especially in Brussels, and businessmen at home and abroad, by giving the finance ministry to Marek Belka and foreign affairs to Wlodzimierz Cimoszewicz. Mr Belka is an economist most businessmen seem to trust. Mr Cimoszewicz must, among other things, fend off Poland's anti-EU nationalists.

Most EU governments still think it politically unthinkable for Poland not to be in the first bunch of new countries joining from the east. But the Poles have been flagging in their negotiations, and there has been growing unease in Brussels. Mr Miller's government is at least better placed than its predecessor to clinch the deal that would bring Poland back into Europe's heart. That is, if Mr Miller can keep the new rowdies in parliament quiet.

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Peacekeeping in Macedonia

Jangling nerves

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A new deal is possible, despite last-minute hitches

Reuters

Can NATO defuse the violence?

VISITING Macedonia soon after the terrorist attacks in America, NATO'S secretary-general, Lord Robertson, described the alliance's search for peace in this southern Balkan state as a “tiny ray of sunshine”. A fortnight on, as NATO wound up its 30-day collection of weapons from the ethnic-Albanian rebels of the National Liberation Army (NLA), and arranged to leave behind 1,000 or so troops to protect the international monitors supervising the peace plan, the gleam still seemed there. But delays by Macedonia's government could still remove it.

The 4,500 NATO soldiers assigned to Operation Essential Harvest have collected more than the agreed quota of 3,300 rebel weapons. Despite opposition from Slav nationalists in Macedonia's ruling party, the country's parliament gave preliminary approval on September 24th to 15 of the 30-plus reforms needed to improve conditions for the country's ethnic-Albanian minority. The violence between Slavs and Albanians, which had seemed about to cause yet another Balkan war, was this week reduced to a single ethnic-Albanian shot dead at a checkpoint. “A resounding success,” said Lord Robertson.

Look again, though, and the clouds still hang around that gleam of hope. Lord Robertson found it necessary this week to remind Macedonia's Slav politicians that they had still not completed their part of the peace deal. The entire bundle of reforms has to be accepted by a two-thirds majority of parliament in a vote due early in October. If the period between the disarming of the NLA and the implementation of the rest of the peace plan continues for too long, violence will return.

The Slav hardliners—led by the prime minister, Ljubco Georgievski, and the even steelier interior minister, Ljube Boskovski—say that ratification would amount to a capitulation to ethnic-Albanian “terrorists”. The leaders of the ethnic Albanians, a third of the country's population, reply that the peace deal will be dead if parliament changes any of the planned reforms.

One of the central issues for the ethnic Albanians is a proposed amnesty. This would give all the rebels, except those of their leaders deemed to have carried out non-political crimes, immunity from prosecution. The Albanians will expect NATO to protect them if it does not go through.

But will NATO be able to provide that protection? Once the soldiers of Essential Harvest have left, by mid-October, about 1,000 allied troops—described by Lord Robertson as a “lean but effective” force, by sourer voices as “overstretched and under-mandated”—will remain to guard the international monitors who are to supervise the country's reintegration. But Macedonia's government is still wrangling over how big NATO's follow-up force should be and how long it should stay.

Some Slav paramilitaries are keen to ensure that this reintegration is a bloody affair for the ethnic Albanians. The Albanians, having been assured by their leader, Ali Ahmeti, that they would be safe if they handed in their weapons to NATO, are worried. They may well have hidden some of their guns. And they could pretty quickly buy some more abroad, given the $30m-40m said to have been collected on their behalf by the Albanian diaspora. Collecting weapons and helping to draft a peace deal was one thing. Making peace work on the ground is something else.

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Italy and the law

Yet more fruits of office

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Proposed new laws may rescue Italy's prime minister from a serious charge

BACK into its stride after the summer holidays, Italy's lower house of parliament was due to vote this week on a controversial bill that was approved in the Senate on August 3rd, the last day before the recess. Its sponsors were Marcello Dell'Utri and five other senators. Ostensibly, the bill simply lets Italy's president, Carlo Azeglio Ciampi, ratify an accord on judicial co-operation between Italy and Switzerland. In fact, it has much more personal implications.

The accord had been agreed on by the two countries back in September 1998. The Swiss parliament swiftly approved it but Italy's centre-left government of the day was dilatory about presenting a simple bill, so it had not been approved by the time parliament was dissolved in March this year, two months before the general election that brought Silvio Berlusconi and his coalition of the right to power. Mr Dell'Utri, a co-founder of Forza Italia, Mr Berlusconi's party, is one of his closest friends. He is on trial for aiding and abetting the Mafia, which he denies. Another of the bill's co-sponsors, all of whom are Forza Italia people, is Paolo Guzzanti, a deputy editor of *il Giornale*, a newspaper controlled by Mr Berlusconi's brother.

Parliament's judicial-affairs committee, sitting with another committee, approved the bill two weeks ago, sending it on its way without amending two articles that would significantly change Italian criminal law. If enacted, they would almost certainly exempt Mr Berlusconi and his friends from the very serious charges they face of bribing judges.

The chairman of the judicial-affairs committee is Gaetano Pecorella, a criminal lawyer who sits for Forza Italia. Another committee member is Niccolo Ghedini. Both men are currently defending Mr Berlusconi against judge-bribing charges, which he denies. In this trial, the prosecution, relying heavily on evidence from bank accounts in Switzerland, alleges that a trail of money connects Mr Berlusconi via intermediaries to the judges.

The alleged intermediaries include Cesare Previti, a former lawyer to Mr Berlusconi's companies who is another long-standing and close friend—and who is also on trial in two further cases of bribery of judges, which he too denies. He is a Forza Italia MP and a former defence minister. These cases, like the others, draw heavily on evidence that has been obtained by Italian prosecutors from Swiss banks.

The Italian-Swiss accord was meant to speed up anti-criminal co-operation. It supplements and updates the European Convention on Mutual Assistance in Criminal Matters, dating from 1959, to which both countries are signatories. Before Italy's election this May, lawyers for defendants in each of the three cases of alleged bribery of judges, in two of which Mr Berlusconi is involved, challenged the admissibility of evidence obtained by Italian prosecutors from their Swiss counterparts.

The challenges asserted that the letter of the 1959 convention had not been observed. For instance, the convention provides that copies of documents should be certified as authentic by the country that is asked for them. As a matter of practice, the Swiss do not certify documentation obtained from banks. Another challenge was based on the mechanisms used to transmit the evidence. The Italian courts rejected all these challenges and ruled that no breach of Italian law had taken place. But the bill's two controversial articles would almost certainly exempt Mr Berlusconi and his friends from judge-bribery charges.

Under Article 12, any evidence that is not acquired or transmitted under the terms of the 1959 convention would be inadmissible in Italian courts. This would apply not only to evidence directly obtained under the convention, but also to any oral testimony derived from that evidence. Under Article

17, this change would apply both to investigations and to proceedings already under way. It is highly unusual for changes to the criminal law to apply to trials already in progress.

In another twist, the same article would probably stop Italian prosecutors from obtaining the same evidence again, by making it inadmissible, in accordance with the letter of the 1959 convention. The lower house, where Mr Berlusconi's coalition has a big majority, was poised to approve the bill this week, until a last-minute opposition amendment, backed by some queasy pro-government deputies, caused it to be sent back to the Senate.

If the bill is finally enacted, prosecutors would be unlikely to persuade courts to continue with any of the three cases of alleged bribery of judges. Mr Berlusconi and his friends would then relax—and Italians would not find out whether their prime minister had indeed bribed judges.

The bill would halt many other investigations and trials, current and future. Criminals involved with the Mafia, or with money-laundering or other corrupt activities, would have a better chance of slipping through the net of justice—if defence lawyers find the merest technical defect in the way evidence has been got from, or transmitted by, any country that has signed the convention of 1959.

A lot of dirty money flows through financial institutions in the Swiss towns of Chiasso and Lugano, where Italian is spoken and which are close to Milan, Italy's main financial centre. At present, the responses by the Swiss authorities to requests for judicial assistance do not usually comply with the letter of the 1959 convention. Unless the authorities in Switzerland are willing to change the way they respond to such requests, the Italians may be unable to obtain admissible evidence from, for instance, Swiss banks.

Bernard Bertossa, Geneva's chief magistrate, complains that “the new Italian government is not committed to fighting crimes such as money-laundering.” It would be unfortunate if the new law were to impede Italy's co-operation with other countries investigating the finances of Osama bin Laden's al-Qaeda network.

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Germany's Greens

Rocking the government

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Worried Greens are rattling Germany's government. Could they even destroy it?

AP

Fischer's converted, but what of the rest?

THE Greens, junior partners to the Social Democrats in Germany's ruling coalition, are so worried by the prospect of their country taking part in military reprisals against terrorism that they may bring down the government. At any rate, that possibility is stirring increasingly fevered speculation among politicians and commentators in Berlin. Could it happen?

At the national level, the party's leaders—an amorphous lot at the best of times—had earlier backed the government's "unlimited solidarity" with the Americans after the attacks of September 11th. But in four of Germany's 16 *Länder* (states), they have already condemned the idea of military retaliation outright. Now the party is at odds with itself—and is threatening to plunge Chancellor Gerhard Schröder's government into a crisis.

Even before the terrorist attacks, the Greens had been edgy and lacking in purpose. In government for the past three years, they have lost much of their *raison d'être* as a party of protest, especially since a deal was struck to phase out nuclear power. Moreover, all Germany's main political parties now profess to share the Greens' environmental concerns.

Besides, the prospects for the party have recently been dimming. In an election on September 23rd in the city-state of Hamburg, their vote slumped by over a third to barely 8%. Opinion pollsters reckon that, if a general election were held tomorrow, the Greens would win only 5-6%, hardly enough to win any seats in the federal parliament.

Some Greens, watching the economic landscape darken, have been wondering for some time whether they would not be wise to leave the coalition now and try instead to forge a new identity before the general election due a year hence. Many dislike the threat to civil liberties posed by the government's planned anti-terrorist measures. Others are appalled by the government's threat to curb still further the right to asylum. The prospect of having to condone the involvement of German soldiers in what would be their first offensive mission since the second world war might now, some believe, prove the last straw.

The Greens' withdrawal from Mr Schröder's government would not necessarily sink it. The Social Democrats could struggle on in a minority. Or they could join forces with Germany's small liberal party, the Free Democrats. Or, perhaps most likely, they could try to build a "grand coalition" with the opposition Christian Democrats, who are in the doldrums and would love to get back into government.

Mr Schröder's red-Green team may yet hold together. Many Greens have mixed feelings. Pollsters say that, although nearly three-quarters of them are against military strikes by the Americans and their allies, as many as two-thirds still want the coalition to survive—even if Germany is sucked into war. Meanwhile, Joschka Fischer, the foreign minister, who is a leading Green convert to the merits of military action in a just cause, remains Mr Schröder's most popular minister.

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Charlemagne

Antonio Vitorino

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Terrorism in America is helping the EU's justice commissioner to make progress

HE USED to joke that “I am a little man and I take little steps forward.” It was a self-deprecating way of making light of his height—he stands 5 feet 3 inches (1.60 metres) in his socks—and of describing the plodding business of creating a European-wide system of justice. But suddenly the diminutive Mr Vitorino has been able to take a giant leap forward. Once deputy prime minister of Portugal, trained as a lawyer and at ease in five languages, he has won plenty of praise in Brussels for his handling of the recently-invented job of European commissioner for justice and home affairs. But trying to expand the EU's role in awkward areas like crime and immigration has been grindingly slow work. “The trouble”, lamented one of his aides this year, “is that these are the issues on which elections are won and lost.”

The attacks on America, however, have utterly changed the atmosphere. Continent-wide action against “a terrorist problem that knows no boundaries” is the new slogan. National sensitivities about protecting old ways of doing things suddenly seem self-indulgent. Spurred on by this new mood, integrationists eager to set up a European police force and a European prosecutor and keen to agree on shared definitions of “Euro-crimes” suddenly sound more plausible. After the terrorist attacks, Mr Vitorino swiftly secured approval from EU governments to go ahead and make provision for a single European arrest warrant, with details to be nailed down by December. Once that is done, the EU's 15 governments must ratify the changes.

Although the arrest-warrant idea was swept through to help fight terror, its reach extends far wider. EU governments will no longer need to go through long extradition procedures to nab suspects sheltering in other European countries. Instead, for any crime that carries a sentence of over a year, a prosecuting authority in one EU country will be able to issue a warrant that must be respected in any other. European countries have hesitated for a couple of years about adopting so far-reaching a measure, since it requires absolute trust in the integrity of each other's legal systems. But those worries look like being set aside, though the Euro-warrant will require constitutional changes in some countries—for example, in Mr Vitorino's Portugal.

Mr Vitorino thinks that in the new climate two nascent institutions, Europol and Eurojust, may also burgeon much faster. Europol, based in The Hague, now shares intelligence between national police forces. Eurojust, which already exists informally and will get going officially at the end of the year, will co-ordinate the EU countries' prosecuting authorities. The time is ripe, says Mr Vitorino, to consider giving Europol the right to initiate its own investigations. Others go further. Gerhard Schröder, Germany's chancellor, has talked of the need for a European FBI. Lionel Jospin, France's prime minister, says Europol should be turned into a Europe-wide police force, implying that it should have executive powers to investigate, search and arrest. The development of Germany's federal police offers a precedent. Like Europol, it started mainly as a co-ordinating body, but won greatly expanded powers to fight terrorism in the 1970s.

Before Europol was granted executive powers, agreement would be needed on some common definitions of Europe-wide crimes; and a European prosecuting authority would need to be able to secure the conviction of criminals collared by Europol. Eurojust is plainly the embryo of such an authority. Enthusiasts, Mr Vitorino probably included, hope that it will move fairly swiftly from co-ordinating national authorities' work to prosecuting selected Euro-crimes itself.

The remit of Europol and Eurojust will depend crucially on how these crimes are defined. Mr Vitorino insists that Europol should concern itself only with cross-border ones. Some issues—he mentions national security and public order—will remain the preserve of national forces. But the commissioner has a long list of cross-border crimes now being defined. Again, the EU's reaction to the attacks of September 11th

provides a lever. At an emergency summit, heads of government agreed to come up with a common definition of terrorism—which may become one of those Euro-crimes for Europol to pursue. A common approach to money-laundering has already been agreed on. Mr Vitorino expects to nail down a definition of people-trafficking fairly soon. Other Euro-crimes in his sights include cyber-crime, environmental offences and financial fraud against the EU.

Stealthy little steps towards a superstate?

All this talk will warm the hearts of enthusiasts for a federal Europe. Mr Vitorino says he is not afraid of the word federalism: “It does not burn my lips.” But he insists that his interest is in practical anti-crime measures, not in a “theological” debate about a federal Europe. The opinion polls, he points out, suggest that support for tighter European integration is strongest in matters of security and crime. But then the builders of a united Europe have always stressed a practical step-by-step approach. As Robert Schuman declared, when that French idealist laid out the goals of European unity in 1950, “Europe will not be conjured up at a stroke or by an overall design; it will be attained by concrete achievements generating a community of interest.”

If Mr Vitorino's “concrete achievements” include creating something like an EU-wide criminal-justice system, he will gain a place in the Union's pantheon of “builders of Europe”. Aged 44, and with a growing reputation for his political and legal nous, he could certainly have a long and influential career in Brussels. Yet it is a testimony to the enduring pull of the nation-state, even for builders of Europe, that many Vitorino-watchers think his ultimate ambitions lie back in Portugal. His old pal, Antonio Guterres, the Portuguese prime minister, is in some political difficulty and may step aside at the next election. At that point little Mr Vitorino might just take another big step—back to Lisbon and into the prime-ministerial chair.

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Britain and America

Who gains?

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AP

British forces are heading to the Gulf to help America's war effort; but for Britain, there are costs, as well as benefits, in the special relationship

“AMERICA has no truer friend than Great Britain.” So said George Bush in his speech to Congress on September 21st. Canadians winced. Tony Blair, up in the gallery, nodded appreciatively. Since 1945, Britain and America have had their ups and downs. In 1956, Eisenhower brought Britain's Suez adventure, its final imperial fling, to a humiliating stop. Harold Wilson refused Lyndon Johnson's appeals to join the Vietnam war. But in two world wars—and in Korea, the Balkans and Kuwait—the two nations have indeed stood “shoulder to shoulder”. What does America gain from this “special relationship”? And what does Britain get in return?

One American gain is military help. A pre-planned British exercise, “Swift Sword”, has put 20,000 servicemen and more than two dozen warships into the Gulf region at just the right time. More important, Britain can offer the Special Air Service (SAS), which specialises in the guerrilla warfare expected in Afghanistan. Britain owns Diego Garcia, in the Indian Ocean, where America keeps a vital base.

All these military assets arouse more excitement in the gunger-ho British newspapers than they deserve. America is not short of fighting men or machines. In the 1991 Gulf war to rescue Kuwait, Britain provided only one armoured division. The SAS had mixed results: one operation to hunt down Iraq's Scud missile-launchers was a flop. In Kosovo, about 800 of the 1,000 or so aircraft committed were American (though Britain has played a big part in the subsequent peacekeeping mission on the ground). Britain shares signals intelligence with the United States, but almost certainly gets back more than it can give.

The respectability Britain confers on America's actions matters more. Britain is the only country which still drops bombs, with America, on Iraq. As a permanent member of the UN Security Council, Britain often casts its veto with America. The British prevent America from looking like a friendless bully, and in turn give it a reason to support Britain's continuing presence at the top table. Another reason for Britain to be on the Security Council is that it has the bomb. But so do several other countries, and the “independent” British nuclear deterrent is nowadays bought off-the-shelf from the United States.

Britain can put friendships at America's disposal. Having spent the first few months of his presidency making enemies—over global warming, missile defences and so on—Mr Bush plainly welcomes Mr Blair's worldwide advocacy on America's behalf. As a former colonial power in the Middle East, Britain has residual loyalties to tap, especially in Jordan and Saudi Arabia. And although its influence in both places

is in decline, British envoys can still reach parts of the Middle East where an American hand of friendship cannot be proffered, or where, if proffered, it might be spurned.

Long before the terror attacks on September 11th, Mr Blair had sent emissaries—including Peter Mandelson, his close friend—to Syria's new president, Bashar Assad. The Syrian president may now visit Britain. Britain has reopened its embassy in Libya, with which America has no relations. This week, Jack Straw became the first British foreign secretary to visit Iran since the Islamic revolution of 1979 (see Bagehot). Though planned before the present crisis, this visit was hurried forward to drive home the point that the West is at war with terrorism, not Islam.

What does Britain gain? A hearing, for a start. During the Korean war, when British troops fought alongside Americans and Britain was judged by Dean Acheson, the American secretary of state, to be America's only dependable ally, Clement Attlee urged caution on Harry Truman. This time round, Mr Bush can probably talk more easily to Mr Blair than to any other world leader. This strengthens Mr Blair's claim that Britain is a “pivotal” power.

But there is a downside. Loyalty to America makes Britain a target. British soldiers are more likely than those of other European nations to be put in harm's way when the shooting begins. And the special relationship has always had a baleful influence on European views of Britain.

In 1962, Kennedy's offer to provide Macmillan with the Polaris missile convinced Charles de Gaulle that Britain's first loyalty would always be to the United States. The French vetoed Britain's request to join the common market. The sympathy that most Europeans now feel towards the United States will not prevent them from noticing the thickening of the old intimacy between America and Britain—still the only big country that has not adopted the European single currency. When the smoke clears, it is hard to believe that the “war against terrorism” will have had no consequences for Britain in Europe.

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Civil liberties

Never shall be slaves

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Britain has a long experience of terrorism and the laws to counteract it

LIBERTY is a less powerful rallying-call in Britain than it is across the Atlantic. Whereas the civil liberties of Americans are enshrined in their constitution, those of Britons evolved messily in the courts. There is no British political equivalent to America's libertarian lobby; last year Jack Straw, then home secretary, dismissed Britain's few civil-liberties activists as “woolly liberals”. Nevertheless, compromising freedom in the name of defeating terrorism may not prove popular.

That is partly because, for many Britons, the argument about balancing security with liberty is an old one. Britain has provided refuge to political fugitives from Marx to the ANC. But since 1974, it has also had tough (according to some, too tough) anti-terrorism laws, which evolved to counter the threat of the IRA. For example, the police are already allowed to detain suspected terrorists for up to a week without charge. The government recently extended the law's remit to cover terrorists planning attacks abroad.

Indeed, the 1974 Prevention of Terrorism Act is a perfect example of hastily introduced, ostensibly temporary, legislation that lingers on the statute books. Roy Jenkins, who was home secretary in 1974, has described it as a “classic example of the truth of the adage that it is only the provisional which lasts”. When efforts to prevent terrorism have curtailed liberty even further, the results have been instructive. In 1971, the army rounded up hundreds of suspected republican terrorists in Northern Ireland and interned them without trial. The botched operation succeeded in radicalising many previously peaceable nationalists.

The unsavoury spectacle of a few domestic extremists advocating *jihad* inclines Britons to ask why more isn't being done to restrain them. But the country already has laws against inciting racial hatred and violence. And the practice known in America as “racial profiling”—targeting particular racial groups—has caused so much tension between the police and minorities that new measures aimed at specific groups may be unworkable.

Your papers, please

What those measures might be remains to be seen. David Blunkett, the home secretary, has said darkly that new anti-terrorism laws may create tension with the Human Rights Act. Apart from some EU-wide proposals—such as the introduction of EU-wide arrest warrants, and fast-track extradition—it is unclear what strictures he has in mind. But one idea that the government is considering is the introduction of compulsory identity cards.

Many other European countries already have ID cards, as did Britain itself during and after the second world war, until Churchill's government disposed of them in 1952. The last Tory government contemplated bringing them back but never actually tried it. The public mood is certainly more favourable now, but unless Mr Blunkett can convince people of their (doubtful) utility in combating terrorism, support for ID cards may recede.

One obstacle to tougher laws could be the fact that Labour has already earned a reputation, in Parliament and beyond, as an enemy of civil liberties—for example, by restricting defendants' right to trial by jury. Liberty, a human-rights lobby group, says that this government has gradually but constantly eroded the rights of suspects. Opponents of ID cards will argue that their real targets are not terrorists but illegal immigrants.

Still, the government will no doubt feel obliged to do something. Whether Parliament and the public ultimately agree depends, as it does elsewhere, on how world-changing they consider the events of September 11th to have been. The scale of the atrocities stunned even the British; but in a country with so much experience of terrorism, the world may seem to have changed just a little less than it has in America.

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Religion and schools

With God on our side

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Worries are growing about the government's enthusiasm for religious schools

THE day before the terrorist atrocities in America, pupils arrived for the first day of the new term at Feversham College in Bradford, Britain's first state-funded Islamic secondary school for girls. Might the two events, however remotely, be connected? Some people fear that they are.

Relations between the country's 2m Muslims and the rest of the population have never been so tense. September 11th has already sparked a small backlash against Muslims. And the terrorist attacks came at the end of a summer of rioting between Muslim and white youths in several towns in the north of England.

Yet the government still wants to press on with its plans to open more religious schools like Feversham. It is encouraging different religions to start up single-denomination schools with taxpayers' money. The Church of England wants to open 100 more such schools. The first Sikh school opened in 1999, and there are already three other Muslim schools.

The events of September 11th have deepened critics' worries about this policy. Lord Alli, a Muslim Labour peer, has already asked the government to think again.

Critics fear that single-faith schools will institutionalise segregation. Children will be brought up ignorant of—or hostile to—other religions. And this could be a breeding ground for the rioters, or terrorists, of the future. After this summer's riots in Bradford, a report on the city's racial divide was published. The report, by Sir Herman Ouseley, a former chairman of the Commission for Racial Equality, warned that “people's attitudes appear to be hardening and intolerance to differences is growing.”

Growing differences between Muslims and Christians are not the only source of worry. The dreadful scenes in Northern Ireland in recent weeks of Protestants baying at children going to a local Catholic primary school have also highlighted the dangers of segregated schooling.

Some Muslims in Bradford say they would prefer their children to go to multi-cultural schools, but that the poor standard of schooling in the city has condemned their children to a cycle of low achievement, unemployment, poverty and crime. Religious schools, which have higher academic standards and better discipline, offer a way out of this trap—and, possibly, into another one.

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Life insurers

Not so resilient

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The regulator is changing its rules to bail out life-insurance companies

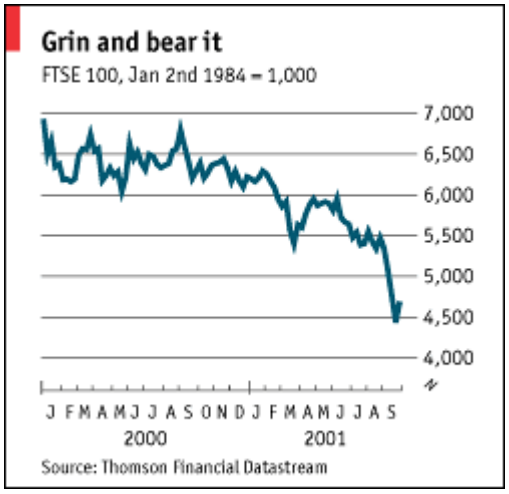
WHEN is a life-insurance company insolvent? The answer is a flexible one, it would seem, after rushed-through changes to the rules governing the sector's statutory solvency requirements. These regulations are supposed to ensure that insurers can meet their commitments to policyholders in bad as well as good times.

In the past two weeks, the Financial Services Authority has twice relaxed the "resilience test" used to work out the reserves life insurers need to protect against stockmarket falls. On September 11th, just before the terrorists struck in America, the FSA said that life insurers needed to cope only with a 10% rather than a 25% fall in equity prices.

This week, the FSA suspended even this guidance and brought forward from December a planned change to the discount rate used to calculate the present value of insurers' future liabilities, which will have the effect of reducing them. It said that a number of companies were close to their solvency limits and that this had triggered forced selling of shares.

No other national regulator has had to make such a change, but in no other country are life insurers as heavily invested in equities as in Britain. Typically, about half of the portfolios of life offices consist of shares—a much higher proportion than in America.

In the bull market of the 1980s and 1990s, British insurers profited from their faith in equities, which have historically out-performed bonds over long holding periods. However, the price for these higher long-run returns is exposure to short-term market declines. The worst bear market since the mid-1970s has hit life insurers hard. Although the London stockmarket made a steadier start to the week's trading, the FTSE 100 index of leading shares closed on September 26th 12% down on the start of the month, a quarter down in 2001 and a third off its all-time high at the start of 2000.



The FSA has no doubt acted with good intentions; and its decision was welcomed by the Association of British Insurers. The regulator argues that there is no point in applying the resilience test blindly if it creates a self-fulfilling spiral of equity declines and breached solvency limits. It also says that this could endanger policyholders' interests in the light of equities' superior long-term returns.

But the resilience test has proved unresilient to the very conditions it was supposed to protect against. The FSA appears to be making it up as it goes along. Its changes bail out the less prudent companies—a bad precedent.

The FSA indicated this week that a comprehensive review of life insurance regulation is under way. The regulator wants to become more proactive in spotting problems with the strategies of individual firms. Reforms are long overdue. The current regulatory system, perplexing to anyone but actuaries, is demonstrably not working if long-standing rules are torn up when the going gets tough.

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Hospitals

Ornamental tables

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From The Economist print edition

Grades for hospitals don't reveal whether they make patients better

“HUMAN kind,” T.S. Eliot once wrote, “cannot bear very much reality.” Alan Milburn, the health secretary, apparently agrees. Last year, he announced plans to classify the performance of English hospital trusts using a simple traffic-light system of green, amber and red. He has since decided that this stark notation isn't such a good idea after all. Last week he published kinder hospital rankings, which, rather like a Michelin guide, award each a number of stars, ranging from three to zero.

Publishing NHS performance statistics isn't new, though presenting them in this composite form is, as are the punishments and rewards that are attached: good hospitals get more autonomy; the managers of bad ones risk being sacked. Mr Milburn's motives are sound. He thinks patients should have more information about the health service they use and pay for. He wants to eliminate the wild variations in competence between different hospitals, even between some in similar neighbourhoods. He also, of course, wants to satisfy voters and keep Labour in power.

But there are two problems with his latest wheeze. The first concerns the value of the published information. Compared with a school, a hospital is a complicated beast to measure. The indicators that the new system is based on—including performance against targets for waiting times, cleanliness, people left hanging around on trolleys, and operations cancelled—are important to patients. But setting targets can lead to all sorts of fixes and fiddles, which do as much harm as good. And the information that would be most useful of all—success rates for individual doctors and medical teams—is not yet available in Britain, as it is in America.

The second problem concerns what patients can do with the information, such as it is. At the moment, they can't do very much. There is some evidence that the shame induced by public comparisons can lever up standards by itself. But that hypothetical improvement will be little consolation to those NHS patients who, because they currently don't have much choice about where they are treated, will be obliged to patronise no-star facilities. Ministers ditched the traffic-light system to avoid giving the impression that some hospitals were dangerous, when the statistics only prove that they are poorly managed. But giving people more knowledge without the power to exploit it could still be alarming.

To be fair, Mr Milburn says he intends to give the public the vital information it needs, and the power to act on it, when it is practicable. Doing so would reveal whether a state-run health service can really treat patients as consumers, which is the government's ambition. Meanwhile, its hospital rankings are about as useful to patients as a guide to exclusive restaurants that doesn't mention the food.

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Liberal Democrats' conference

Their hour come round at last?

Sep 27th 2001 | BOURNEMOUTH
From The Economist print edition

How the Liberal Democrats plan to become the main opposition party

Kennedy has seen the light

TONY BLAIR'S decision to recall Parliament next week to discuss military retaliation against terrorism has left the British political conference season in disarray. Both Labour and the Conservatives are to cut short their conferences to two days. The Liberal Democrats, whose meeting was held this week in Bournemouth, went ahead as planned though imminent military action dominated the thoughts of those who attended.

In other circumstances, the Lib Dems would have been celebrating the third party's best election performance for more than 70 years. The party has never been shy of talking up its prospects. Confident predictions were being made that it is on track to displace the Conservatives as the real opposition to the Labour government.

For a party which still has only a third as many MPs as the Tories, this is bold. Yet the Lib Dems, for so long scorned as an irrelevant receptacle of wasted votes, can be forgiven a moment of hubris. They have more MPs than at any time since 1929, but the extent of this achievement has been masked by the size of Labour's majority. Nearly 5m votes and 52 seats would have represented real power in many previous parliaments.

The Tories have given the Lib Dems further encouragement. The election of Iain Duncan Smith as party leader and his selection of a right-wing shadow cabinet has played into the Lib Dems' hands.

Lord Rennard, the Lib Dems' director of campaigns, claims that his party could double its number of MPs and overtake the Tories. Others are more cautious. The party's strategists realise that the Lib Dems are unlikely to attract more than a small fraction of the Tories' core vote. “What we are not going to be”, says one of them, “is a centre-right party. If the electorate want that, there is a vacancy.”

The general view among Lib Dems is that by putting on one side their old obsessions—such as electoral reform—and concentrating on the big issues that concern the public—education, health, transport and care of the elderly—they can become the effective opposition. Yet very few even tentative solutions for how to improve the performance of the public services were on offer at the conference.

A debate on the role of private finance in health care provoked a revolt demanding a moratorium on all such deals until an independent review has been conducted. The party is split between those, such as Evan Harris, the health spokesman, who believe that chronic underfunding is the main problem, and Matthew Taylor, the economic spokesman, who argues that the party must embrace new ways of delivering public services. Consumers, he pointed out, were interested in the quality of services, not who delivered them.

The issue is so divisive that it has been handed to a policy commission headed by Chris Huhne, an MEP and economist. The commission is to report next year on ways to improve the public services. The Lib Dems are toying with an idea which Charles Kennedy, the party's leader, floated this summer of increasing NHS funding by introducing a health tax based on national insurance contributions.

Until now, the Lib Dems have relished their reputation as a tax and spend party. But Mr Kennedy's policy advisers believe that this must change if the party is to be seen as a serious challenger for government. If the conference is anything to go by, however, they have yet to persuade the membership of this.

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Cheese

Breaking the mould

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The British cheese business is maturing

CHARLES DE GAULLE once said of France, “How can you govern a country which has 246 varieties of cheese?” By that measure, Britain should be sliding into anarchy, for it now makes over 400 varieties, up from around 350 five years ago.

Gallic rhetoric notwithstanding, developments in the British cheese market have more to do with economics than with politics. Producing agricultural commodities—milk, meat, wheat—is a miserable business these days, so farmers are looking for markets where there is scope for adding more value and so for making more money.

Many are turning to cheese. For the craftsman, there is plenty of scope for increasing quality by using traditional methods. Many of the new cheeses are made by hand in small batches, often bound in cloth in the time-honoured fashion. And for the overheated imagination, there is infinite scope for invention. One company produces cheddar with chillies, Double Gloucester with onions, and Wensleydale with apricots.

A taste of this proliferation will be on offer this weekend at the annual British Cheese Festival in Stow-on-the-Wold in Gloucestershire. This year a record 726 cheeses have been entered for the coveted British Cheese Awards, twice as many as in the mid-1990s.

But most consumers are only dimly aware of these exciting developments. The average British cheese-eater is an unadventurous beast. Plain old cheddar still dominates his cheeseboard, leaving only a sliver of the market to Cornish Yarg, Ticklemore, Stinking Bishop and the like. When he wants something a little wilder, he usually goes for cheeses from mainland Europe. Cheese tops the list of British food imports.

Might the taste for fancy British cheese spread? Tim Rowcliffe, who heads the Specialist Cheesemakers Association, hopes for a revival of farmhouse cheese similar to the re-emergence of locally brewed “real ale” in the 1980s. But he is realistic about his chances of success. “Beer captures the imagination more than cheese does,” he says sadly.

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Bagehot

See some evil

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Britain debates the morality of terror, reaching no clear answer

THE mass murder at the World Trade Centre was so terrible that it was easy a week ago to speak in moral absolutes. No plea, it seemed, could be entered in mitigation of an act so plainly evil. But the crime requires a response, and the response, perforce, will take place in the domain of *Realpolitik*. Here, as Jack Straw, the foreign secretary, discovered in the Middle East this week, morality turns out to have slippery gradations.

Before June's general election, Mr Straw was home secretary, which means it fell to him to put into practice New Labour's motto that the new government would be “tough on crime, tough on the causes of crime”. It is generally agreed even by his admirers that Mr Straw did not proceed very far beyond the first half of this mission. As a draconian home secretary, he cracked down hard on crime, leaving other departments to work on—and out—the things that caused people to commit crimes in the first place. So it is noteworthy that this same Mr Straw was this week under fire for having turned his priorities upside down.

The war against terrorism, says George Bush, is no less than a global war of good against evil. Officially, Britain concurs. But on a visit to Iran, the first by a British foreign secretary since the Islamic revolution of 1979, Mr Straw was talking tough not only about terrorism but also about what he thinks are its causes. In an article for an Iranian newspaper, he said he understood that “one of the factors which helps to breed terrorism is the anger which many people in this region feel at events over the years in Palestine.” This caused pandemonium in Israel, which he visited afterwards. The Israelis were so furious that it took a 15-minute telephone call from Tony Blair to talk Ariel Sharon, the Israeli prime minister, into meeting Mr Straw at all.

Back in London, the Foreign Office affected amazement. In British eyes, Mr Straw's remarks were entirely innocuous—a statement, in fact, of the obvious. Surely nobody can set foot in the Muslim world without noticing how much Israel is hated as a result of its conflict with the Palestinians?

Well, perhaps the Foreign Office should not be quite so easy on itself. What inflamed Israelis was Mr Straw's selectivity. By “understanding” the terrorism-breeding anger that Muslims feel about Israel, he appeared to single out Israel's policies as the indirect cause of the atrocity in America. He made no mention of the other grievances, such as America's bases in the Middle East (Iran hates them too) and

its support of Saudi Arabia, which appear to count for more in the *fatwa* issued by Osama bin Laden, still the prime suspect, against America and its people. Moreover, Mr Straw made these remarks in a country whose proposed solution to the Palestinian problem is to destroy Israel, and which, according to the American State Department, sponsors terrorist organisations dedicated to precisely that end.

Still, it would be wrong to hang too much on Mr Straw. He is merely applying, as the times demand, the calculus which makes the enemy (Iran) of my enemy (Afghanistan) into my friend. No country building a big coalition in the Middle East can afford to be pernickety about terrorism. And Britain, with a long history of fighting and then dealing with terrorists as it withdrew from empire, has less reason than most to be fastidious. Britain, after all, has home-grown terrorism too.

The Irish complication

The IRA has never tried to kill 7,000 people all at once. But among its many outrages was an attempt to blow up the British cabinet in a Brighton hotel. It bombed Canary Wharf, the nearest British equivalent of the World Trade Centre, and fired mortars at Downing Street. It is now observing a ceasefire, but has still not decommissioned any of its weapons, as it was expected to in return for the creation of the Northern Ireland Assembly, in which Sinn Fein, its political arm, plays a prominent part.

All this makes the government's new war on terrorism hard for some to bear. David Trimble, leader of the Ulster Unionist Party, complained this week that events in America have exposed a glaring contradiction between the British government's stance on international terrorism and its handling of the IRA. Mr Blair is tough on the former, but John Reid, his Northern Ireland secretary, shows “disgusting pusillanimity” towards the latter. The IRA refuses to decommission, and yet Mr Reid refuses either to suspend the Northern Ireland Assembly or force Sinn Fein out of it. Iain Duncan Smith, the Tories' new leader, warns Mr Blair that he is in danger of operating a double standard by declaring war on terrorism while tolerating the IRA.

Peter Mandelson, the former Northern Ireland secretary, made an attempt in the *Guardian* this week to sift through these moral confusions. The IRA, however despicable its methods, was supported by democratic parties, enjoyed widespread legitimacy and—once it gave up trying to remove Britain by force—had negotiable demands. Mr bin Laden's networks, by contrast, “are not political organisations with ideals or a set of negotiable demands—save driving Israel into the sea and expelling America from the Middle East.” They will never, Mr Mandelson concluded, renounce terrorism. “They must have the means of terror forcibly taken from them because that is the only way we will protect ourselves from further slaughter.”

Amen, where the prescription is concerned. As for morality, are there really better and worse terrorists? If anything, doesn't it make it worse, not better, that the IRA operated politically, in a mature democracy, and still resorted to terror? Mr bin Laden, with no democratic way to remove the Saudi regime, may enjoy at least as much legitimacy among Arabs as the monarchies and dictatorships Mr Straw and his counterparts are lining up. No: the true and just reason for the West to wage war on him is that he has waged war on it, showing the utmost ingenuity and ruthlessness. Who needs a comparative theory of terrorism, when self-preservation is at stake?

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Globalisation and its critics

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Globalisation is a great force for good. But neither governments nor businesses, Clive Crook argues, can be trusted to make the case

PUBLICATION of this survey had originally been intended to coincide with the annual meetings of the World Bank and the International Monetary Fund, scheduled for September 29th-30th in Washington, DC. Those meetings, and the big anti-globalisation protests that had been planned to accompany them, were among the least significant casualties of the terrorist atrocities of September 11th.

You might have thought that the anti-capitalist protesters, after contemplating those horrors and their aftermath, would be regretting more than just the loss of a venue for their marches. Many are, no doubt. But judging by the response of some of their leaders and many of the activists (if Internet chat rooms are any guide), grief is not always the prevailing mood. Some anti-globalists have found a kind of consolation, even a cause of satisfaction, in these terrible events—that of having been, as they see it, proved right.

To its fiercest critics, globalisation, the march of international capitalism, is a force for oppression, exploitation and injustice. The rage that drove the terrorists to commit their obscene crime was in part, it is argued, a response to that. At the very least, it is suggested, terrorism thrives on poverty—and international capitalism, the protesters say, thrives on poverty too.

Far from being the greatest cause of poverty, globalisation is the only feasible cure

These may be extreme positions, but the minority that holds them is not tiny, by any means. Far more important, the anti-globalists have lately drawn tacit support—if nothing else, a reluctance to condemn—from a broad range of public opinion. As a result, they have been, and are likely to remain, politically influential. At a time such as this, sorting through issues of political economy may seem very far removed from what matters. In one sense, it is. But when many in the West are contemplating their future with new foreboding, it is important to understand why the sceptics are wrong; why economic integration is a force for good; and why globalisation, far from being the greatest cause of poverty, is its only feasible cure.

Undeniably, popular support for that view is lacking. In the developed economies, support for further trade liberalisation is uncertain; in some countries, voters are downright hostile to it. Starting a new round of global trade talks this year will be a struggle, and seeing it through to a useful conclusion will be harder. The institutions that in most people's eyes represent the global economy—the IMF, the World Bank and the World Trade Organisation—are reviled far more widely than they are admired; the best they can expect from opinion at large is grudging acceptance. Governments, meanwhile, are accused of bowing down to business: globalisation leaves them no choice. Private capital moves across the planet unchecked. Wherever it goes, it bleeds democracy of content and puts “profits before people”.

Who will speak up for international capitalism? Governments and businesses. What a pity that is. These supposed defenders of globalisation may do more to undermine support for it than the critics.

Rich-country governments generally present economic integration to voters as an unfortunate but inescapable fact of life: as a constraint, that is, on their freedom of action. For the past ten years, this has been the favourite excuse of any government about to break an election promise.

Multinational businesses, for their part, with their enlightened mission statements, progressive

stakeholder strategies, flower-motif logos and 57-point pledges of “corporate social responsibility”, implicitly say that they have a case to answer: capitalism without responsibility is bad. That sounds all right; the trouble is, when they start talking about how they will no longer put profits first, people (rightly) think they are lying. If, as these defenders of economies without borders lead you to conclude, global capitalism is a cause of democratic paralysis and a cloak for old-fashioned corporate venality, even instinctive liberals ought to side with the sceptics.

With advocates like these on either side of the globalisation debate—dissembling governments and businesses in favour, angry and uncompromising protesters against—it is natural that the general public stands firmly in support of neither. It has no deep commitment to international capitalism, but it can see no plausible alternative. Certainly, the protesters do not appear to be offering one. So people are mostly puzzled, anxious and suspicious. This climate of opinion is bad for democracy and bad for economic development.

This survey offers a few suggestions for a more purposeful kind of discussion. It would be foolish to suppose that consensus will ever be possible. Some of the sceptics are opposed not just to globalisation or even to the market economy but to the very idea of economic growth. That view has the virtue of coherence, at least, but it is unlikely in the foreseeable future to command a large following.

Nonetheless, in among all their weak arguments, dangerous good intentions and downright loony notions, the sceptics are hiding some important points. Clarifying what makes sense in the sceptics' case, and exposing the mistaken or dishonest arguments that politicians and businessmen are putting up against them, may serve some purpose. And a clearer understanding of the arguments for globalisation, of the problems it solves as well as the problems it creates, may help as well.

Good old invisible hand

The strongest case for globalisation is the liberal one. It is almost never heard, least of all from governments or businessmen. International economic integration, on the liberal view, is what happens when technology allows people to pursue their own goals and they are given the liberty to do so. If technology advances to the point where it supports trade across borders, and if people then choose to trade across borders, you have integration, and because people have freely chosen it this is a good thing. Also, again because people have freely chosen this course, you would expect there to be economic benefits as well.

By and large, theory and practice confirm that this is so. Adam Smith's invisible hand does its work. People choose what serves their own self-interest, each of them making that judgment for himself. The result is that society as a whole prospers and advances—spontaneously, not by design of any person or government.

All kinds of qualifications and elaborations are needed, obviously, to fill out the argument properly. This survey will offer some of them in due course. But it is essential to understand one point from the outset. The liberal case for globalisation is emphatically not the case for domestic or international laisser faire. Liberalism lays down no certainties about the requirements of social justice in terms of income redistribution or the extent of the welfare state. It recognises that markets have their limits, for instance in tending to the supply of public goods (such as a clean environment). A liberal outlook is consistent with support for a wide range of government interventions; indeed a liberal outlook demands many such interventions.

A liberal outlook is consistent with a wide range of government interventions. Indeed, it often demands them

But the starting point for all liberals is a presumption that, under ordinary circumstances, the individual knows best what serves his interests and that the blending of these individual choices will produce socially good results. Two other things follow. The first is an initial scepticism, at least, about collective decision-making that overrides the individual kind. The other is a high regard for markets—not as a place where profits are made, it must be stressed, but as a place where society advances in the common good.

Why then are governments and business leaders rarely heard to put this case? Because for the most part they are not liberals. Perhaps it goes with the job that politicians of left and right, traditional and modern, have an exaggerated view of their ability to improve on the spontaneous order of a lightly governed society.

It would be even more naive, and contrary to all experience, to expect business itself to favour a liberal outlook. Businesses are ultimately interested in one thing: profits. The business-bashing NGOs are right about that. If businesses think that treating their customers and staff well, or adopting a policy of "corporate social responsibility", or using ecologically friendly stationery will add to their profits, they will do it. Otherwise, they will not.

Does that make market capitalism wrong? On the contrary, the point of a liberal market economy is that it civilises the quest for profit, turning it, willy-nilly, into an engine of social progress. If firms have to compete with rivals for customers and workers, then they will indeed worry about their reputation for quality and fair dealing—even if they do not value those things in themselves. Competition will make them behave as if they did.

Here, then, is where the anti-business NGOs get their argument completely upside down—with genuinely dangerous consequences for the causes, sometimes just, which they hope to advance. On the whole, stricter regulation of international business is not going to reduce profits: the costs will be passed along to consumers. And it is not going to diminish any company's interest in making profits. What it may well do, though, by disabling markets in their civilising role, is to give companies new opportunities to make even bigger profits at the expense of society at large.

For example, suppose that in the remorseless search for profit, multinationals pay sweatshop wages to their workers in developing countries. Regulation forcing them to pay higher wages is demanded. The biggest western firms concede there might be merit in the idea. But justice and efficiency require a level playing-field. The NGOs, the reformed multinationals and enlightened rich-country governments propose tough rules on third-world factory wages, backed up by trade barriers to keep out imports from countries that do not comply. Shoppers in the West pay more—but willingly, because they know it is in a good cause. The NGOs declare another victory. The companies, having shafted their third-world competition and protected their domestic markets, count their bigger profits (higher wage costs notwithstanding). And the third-world workers displaced from locally owned factories explain to their children why the West's new deal for the victims of capitalism requires them to starve.

If firms ruled the world

A fashionable strand of scepticism argues that governments have surrendered their power to capitalism—that the world's biggest companies are nowadays more powerful than many of the world's governments. Democracy is a sham. Profits rule, not people. These claims are patent nonsense. On the other hand, there is no question that companies would run the world for profit if they could. What stops them is not governments, powerful as they may be, but markets.

Governments have the power, all right, but they do not always exercise it wisely. They are unreliable servants of the public interest. Sometimes, out of conviction, politicians decide to help companies reshape the world for private profit. Sometimes, anti-market thinking may lead them to help big business by accident. And now and then, when companies just set out to buy the policies they want, they find in government a willing seller. On all this, presumably, the sceptics would agree.

But they miss the next crucial step: limited government is not worth buying. Markets keep the spoils of corruption small. Government that intervenes left and right, prohibiting this and licensing that, creating surpluses and shortages—now that kind of government is worth a bit. That is why, especially in developing countries with weak legal systems, taming capitalism by regulation or trade protection often proves such a hazardous endeavour.

If NGOs succeeded in disabling markets, as many of them say they would like to, the political consequences would be as dire as the economic ones. It is because the sceptics are right about some things that they are so wrong about the main thing.

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Profits over people

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Critics argue that globalisation hurts workers. Are they right?

THE liberty that makes economic integration possible is desirable in itself. In addition, advocates of globalisation argue, integration is good for people in material terms—that is why free people choose it. Sceptics disagree on both points: globalisation militates against liberty and democracy, they say, and while it makes some people who are already rich even richer, it does this by keeping the poor in poverty. After all, globalisation is merely capitalism writ large. A later chapter of this survey will deal with the implications of globalisation for democracy. But first, is it true that globalisation harms the poor?

In a narrow sense, the answer is yes: it does harm some of the poor. Free trade and foreign direct investment may take jobs from workers (including low-paid workers) in the advanced industrial economies and give them to cheaper workers in poor countries. Thanks to the North American Free-Trade Agreement (NAFTA), for instance, there are no tariffs or investment restrictions to stop an American manufacturer closing an old factory in the United States and opening a new one in Mexico.

Sceptics score this strategy as a double crime. The rich-country workers, who were probably on low wages by local standards to begin with, are out of work. That increase in the local supply of labour drives down other wages. Meanwhile, the poor-country workers are drawn into jobs that exploit them. How do you know that the poor-country workers are being exploited? Because they are being paid less, often much less, than their rich-country counterparts got before trade opened up—and in all likelihood they are working longer hours in shabbier premises as well. The only gain from this kind of trade, the indictment continues, accrues to the owners of the companies who have shifted their operations from low-wage factories in industrialised countries to poverty-wage factories in the south.

Some of this is true. Trade displaces workers in the industrialised countries; other things equal, this will have some depressing effect on the wages of other workers; and pay and conditions in developing-country factories are likely to be worse than in their rich-country counterparts. But whereas the displaced rich-country workers are plainly worse off than they were before, the newly employed poor-country workers are plainly better off. They must be, because they have chosen to take those jobs.

As for profits, yes, that is the spur for moving production to a lower-wage area. But no company can expect to hang on to this windfall for long, because it will be competed away as other companies do the same thing and cut their prices. That lowering of prices is crucial in understanding the broader benefits of the change. It is what makes consumers at large—including poor consumers—better off, raising real incomes in the aggregate.

Altogether, given freer trade, both rich-country and poor-country living standards will rise

What about the rich-country workers who are not displaced, but whose wages may nonetheless come under downward pressure? It is hard to generalise. On the one hand, their wages may fall, or fail to rise as quickly as they would have done otherwise; on the other, they benefit from lower prices along with everybody else. On balance, you would expect that some will lose, some will gain, and some will be about as well off as they were before. In developing countries, the labour-market side of this process will tend to work in the other direction. The increase in demand for poor-country labour ought to push up wages even for workers who are not employed in the new trade-related jobs.

So capitalism-globalisation is not mainly concerned with shifting income from workers to investors, as the sceptics maintain. Rather, it makes some workers worse off while making others (including the poorest ones of all, to begin with) better off. And in the aggregate it makes consumers (that is, people with or without a job) better off as well. Altogether, given freer trade, both rich-country and poor-country living standards rise. That gives governments more to spend on welfare, education and other public services.

Changing gear

Note that all this counts only the so-called static gains from trade: the effects of a once-and-for-all shift in the pattern of production and consumption. Modern economics also emphasises the importance of dynamic gains, arising especially from the economies of scale that freer trade makes possible. The aggregate long-term gain for rich and poor countries alike is likely to be far bigger than the simple arithmetic would suggest.

Moreover, few displaced rich-country workers are likely to be permanently out of work. Most will move to other jobs. Also, new jobs will be created by the economic opportunities that trade opens up. Overall, trade neither reduces the number of jobs in the economy nor increases them. In principle, there is no reason to expect employment or unemployment to be any higher or lower in an open economy than in a closed economy—or, for that matter, in a rich economy as compared to a poor economy. Still, none of this is to deny that the displaced rich-country workers lose out: many, perhaps most, of those who find alternative work will be paid less than they were before.

In thinking through the economic theory of liberal trade, it is helpful to draw a parallel with technological progress. Trade allows a country to shift its pattern of production in such a way that, after exporting those goods it does not want and importing those it does, it can consume more without there having been any increase in its available resources. Advancing technology allows a country to do something very similar: to make more with less. You can think of trade as a machine (with no running costs or depreciation): goods you can make cheaply go in at one end, and goods that would cost you a lot more to make come out at the other. The logic of protectionism would demand that such a miraculous machine be dismantled and the blueprint destroyed, in order to save jobs.

No question, technological progress, just like trade, creates losers as well as winners. The Industrial Revolution involved hugely painful economic and social dislocations—though nearly everybody would now agree that the gains in human welfare were worth the cost. Even in far milder periods of economic transformation, such as today's, new machines and new methods make old skills obsolete. The Luddites understood that, which made them more coherent on the subject than some of today's sceptics, who oppose integration but not technological progress. Logically, they should oppose both or neither.

Politically, of course, it is essential to keep the two separate. Sceptics can expect to win popular support for the view that freer trade is harmful, but could never hope to gain broad backing for the idea that, so far as possible, technological progress should be brought to a halt. Still, it might be better if the sceptics concentrated not on attacking trade as such, but on demanding help for the workers who suffer as a result of economic progress, whether the cause is trade or technology.

Winners and losers

So much for the basic theory. What does the evidence say? For the moment, concentrate on the prospects for workers in rich countries such as the United States (the next section will look in more detail at workers in poor countries). By and large, the evidence agrees with the theory—though things, as always, get more complicated the closer you look.

A first qualification is that most outward foreign direct investment (FDI) from rich countries goes not to poor countries at all, but to other rich countries. In the late 1990s, roughly 80% of the stock of America's outward FDI was in Canada, Japan and Western Europe, and nearly all of the rest was in middle-income developing countries such as Brazil, Mexico, Indonesia and Thailand. The poorest developing countries accounted for 1% of America's outward FDI (see table 1). Capital is hardly flooding to the world's poorest countries—more's the pity, from their point of view.

Where the money goes 1

America's stock of direct investment overseas, 2000

	$bn	% of total
High-income countries	982.8	81.0
Middle-income countries	218.1	18.0
Low-income countries	12.2	1.0
All countries	1,213.1	100.0

Sources: Edward M. Graham, Institute for International Economics; *The Economist*

The notion that outward FDI reduces the demand for labour in the sending country and increases it in the receiving one needs to be revised as well. It was based on the assumption that when rich-country firms invest in poor countries, rich-country exports (and jobs) are replaced by poor-country domestic production. In fact, evidence from the United States and other countries suggests that outward FDI does not displace exports, it creates them: FDI and exports are, in the jargon, net complements. This is because the affiliates of multinationals trade with each other. Figures for 1995 show that America's exports to its foreign-owned

affiliates actually exceeded its imports from them (see table 2).

Before FDI, the companies exported finished goods. After FDI, they ship, let us suppose, a mixture of finished goods and intermediate goods. The intermediate goods will be used to make finished goods in the FDI-receiving country. The corresponding increase in exports of intermediate goods outweighs the fall, if any, in exports of finished goods. Overall, then, exports from the FDI-sending country rise. At the same time, the sending country's imports rise as well, partly because the affiliate sells goods back to the sending country. Exports rise, which increases the demand for labour; and imports rise, which decreases the demand for labour.

Keeping it in the family 2

American exports to, and imports from, American-owned affiliates abroad, 1995, $bn

	Intra-company	Inter-company	Total
All countries			
Exports	145.5	24.5	170.0
Imports	123.9	19.4	143.3
Balance	21.6	5.1	26.7
High-income countries			
Exports	129.0	20.8	149.9
Imports	94.0	15.1	109.1
Balance	35.0	5.7	40.7
Middle-income countries			
Exports	28.9	5.4	34.3
Imports	31.5	1.9	33.4
Balance	-2.6	3.5	0.8
Low-income countries			
Exports	1.6	0.2	1.8
Imports	1.8	0.4	2.2
Balance	-0.2	-0.2	-0.4

Source: Edward M. Graham, Institute for International Economics

What does all this mean for the labour markets of the rich, FDI-sending countries? Jobs are created in exporting industries which will tend to be relatively high-paying, but overall employment will not rise, for reasons explained earlier. For every job created, another one somewhere else will be destroyed. The jobs that go will tend to be in industries that compete with imports. On average, studies suggest, those jobs pay lower wages.

On balance, then, you could say that the economy has gained: it now has more higher-paying jobs and fewer lower-paying jobs. A policy which attempted to resist a shift like that would be difficult to defend on its merits. Unfortunately, though, the people getting the higher-paying jobs are not necessarily the ones who have lost the lower-paying jobs. Because of the boost to exports, the overall effect of outward FDI on jobs and wages in the sending country is more benign than the simple theory suggests—but some people still lose.

Another implication of the shift in the demand for labour in the rich, FDI-sending countries is a possible widening of income inequality. In a country such as the United States, the combined action of trade and capital flows is likely to raise the demand for relatively skilled labour and lower the demand for relatively unskilled labour. Some hitherto low-wage workers may succeed in trading up to higher-paid jobs, but many others will be left behind in industries where wages are falling. In this scenario, high and average wages may be rising, but wages at the bottom may be falling—and that means greater inequality.

You would expect to see a similar pattern in an economy that was undergoing rapid technological change. So in the United States, which fits that description better than most in the 1990s, you could say that economic integration may have added to the already powerful pressures that were acting to increase inequality. Since those same pressures were raising living standards in the aggregate—not just for the very rich—it would be a misleading summary, but not a false one.

Explaining inequality

Of these two unequalising forces, economic integration and technological progress, which is likely to be more powerful? If it were the latter, that would raise doubts over the sceptics' focus on globalisation as the primary cause of social friction. The evidence suggests that technology is indeed much the more powerful driver of inequality. One study, by William Cline, estimated that technological change was perhaps five times more powerful in widening inequality in America between 1973 and 1993 than trade (including trade due to FDI), and that trade accounted for only around six percentage points of all the unequalising forces at work during that period. That is just one study, but it is not unrepresentative. The consensus is that integration has exerted a far milder influence on wage inequality than technology.

Mr Cline's study in fact deserves a closer look. It found to begin with that the total increase in the ratio of skilled to unskilled wages in the two decades to the early 1990s was 18%. This was the net result of opposing influences. An increase in the supply of skilled labour relative to the supply of unskilled labour acted to equalise wages, by making unskilled labour relatively scarce. By itself, this would have driven the wage ratio down by 40% (see table 3). But at the same time a variety of unequalising forces

pushed the ratio up by 97%, resulting in the net increase of 18%. These unequalising forces included not just trade and technology, but also immigration, reductions in the real value of the minimum wage, and de-unionisation.

Two things strike you about the numbers. First, trade has been relatively unimportant in widening income inequality. Second, this effect is overwhelmed not just by technology but also by the main force operating in the opposite, equalising, direction: education and training.

This means that globalisation sceptics are missing the point if they are worried mainly about the effect of integration on rich-country losers: trade is a much smaller factor than technology. Some people in rich countries do lose out from the combination of trade and technology. The remedy lies with education and training, and with help in changing jobs. Spending in those areas, together perhaps with more generous and effective help for people forced to change jobs by economic growth, addresses the problem directly—and in a way that adds to society's economic resources rather than subtracting from them, as efforts to hold back either technological progress or trade would do.

Getting less equal 3

Illustrative sources of increase in the ratio of skilled to unskilled wages in the United States 1973-93, %

A. Equalising forces	
Increase in stock of skilled relative to unskilled labour	*-40*
B. Unequalising forces	
Trade:	7
Lower transport and communication costs	3
Liberalisation	3
Outsourcing	1
Immigration	2
Falling minimum wage	5
Deunionisation	3
Skill-biased technological change	29
Other unexplained	29
TOTAL	*97*
C. Net effect	***18***

Note: Percentages for unequalising forces must be chained, not added, to equal total unequalising effect. Similarly, "A" and "B" must be chained to calculate "C".

Source: William R. Cline, Institute for International Economics

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Grinding the poor

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Sceptics charge that globalisation especially hurts poor workers in the developing countries. It does not

FOR the most part, it seems, workers in rich countries have little to fear from globalisation, and a lot to gain. But is the same thing true for workers in poor countries? The answer is that they are even more likely than their rich-country counterparts to benefit, because they have less to lose and more to gain.

Orthodox economics takes an optimistic line on integration and the developing countries. Openness to foreign trade and investment should encourage capital to flow to poor economies. In the developing world, capital is scarce, so the returns on investment there should be higher than in the industrialised countries, where the best opportunities to make money by adding capital to labour have already been used up. If poor countries lower their barriers to trade and investment, the theory goes, rich foreigners will want to send over some of their capital.

If this inflow of resources arrives in the form of loans or portfolio investment, it will supplement domestic savings and loosen the financial constraint on additional investment by local companies. If it arrives in the form of new foreign-controlled operations, FDI, so much the better: this kind of capital brings technology and skills from abroad packaged along with it, with less financial risk as well. In either case, the addition to investment ought to push incomes up, partly by raising the demand for labour and partly by making labour more productive.

This is why workers in FDI-receiving countries should be in an even better position to profit from integration than workers in FDI-sending countries. Also, with or without inflows of foreign capital, the same static and dynamic gains from trade should apply in developing countries as in rich ones. This gains-from-trade logic often arouses suspicion, because the benefits seem to come from nowhere. Surely one side or the other must lose. Not so. The benefits that a rich country gets through trade do not come at the expense of its poor-country trading partners, or vice versa. Recall that according to the theory, trade is a positive-sum game. In all these transactions, both sides—exporters and importers, borrowers and lenders, shareholders and workers—can gain.

What, if anything, might spoil the simple theory and make things go awry? Plenty, say the sceptics.

First, they argue, telling developing countries to grow through trade, rather than through building industries to serve domestic markets, involves a fallacy of composition. If all poor countries tried to do this simultaneously, the price of their exports would be driven down on world markets. The success of the East Asian tigers, the argument continues, owed much to the fact that so many other developing countries chose to discourage trade rather than promote it. This theory of “export pessimism” was influential with many developing-country governments up until the 1980s, and seems to lie behind the thinking of many sceptics today.

A second objection to the openness-is-good orthodoxy concerns not trade but FDI. The standard thinking assumes that foreign capital pays for investment that makes economic sense—the kind that will foster development. Experience shows that this is often not so. For one reason or another, the inflow of capital may produce little or nothing of value, sometimes less than nothing. The money may be wasted or stolen. If it was borrowed, all there will be to show for it is an insupportable debt to foreigners. Far from merely failing to advance development, this kind of financial integration sets it back.

Third, the sceptics point out, workers in developing countries lack the rights, legal protections and union

representation enjoyed by their counterparts in rich countries. This is why, in the eyes of the multinationals, hiring them makes such good sense. Lacking in bargaining power, workers do not benefit as they should from an increase in the demand for labour. Their wages do not go up. They may have no choice but to work in sweatshops, suffering unhealthy or dangerous conditions, excessive hours or even physical abuse. In the worst cases, children as well as adults are the victims.

Is trade good for growth?

All this seems very complicated. Can the doubters be answered simply by measuring the overall effect of openness on economic growth? Some economists think so, and have produced a variety of much-quoted econometric studies apparently confirming that trade promotes development. Studies by Jeffrey Sachs and Andrew Warner at Harvard, by David Dollar and Aart Kraay of the World Bank, and by Jeffrey Frankel of Harvard and David Romer of Berkeley, are among the most frequently cited. Studies such as these are enough to convince most economists that trade does indeed promote growth. But they cannot be said to settle the matter. If the application of econometrics to other big, complicated questions in economics is any guide, they probably never will: the precise economic linkages that underlie the correlations may always be too difficult to uncover.

This is why a good number of economists, including some of the most distinguished advocates of liberal trade, are unpersuaded by this kind of work. For every regression “proving” that trade promotes growth, it is too easy to tweak a choice of variable here and a period of analysis there to “prove” that it does not. Among the sceptics, Dani Rodrik has led the assault on the pro-trade regression studies. But economists such as Jagdish Bhagwati and T.N. Srinivasan, both celebrated advocates of trade liberalisation, are also pretty scathing about the regression evidence.

Can the doubters be answered simply by measuring the effect of openness on economic growth?

Look elsewhere, though, and there is no lack of additional evidence, albeit of a more variegated and less easily summarised sort, that trade promotes development. Of the three criticisms just stated of the orthodox preference for liberal trade, the first and most influential down the years has been the “export pessimism” argument—the idea that liberalising trade will be self-defeating if too many developing countries try to do it simultaneously. What does the evidence say about that?

Pessimism confounded

It does not say that the claim is nonsense. History shows that the prediction of persistently falling export prices has proved correct for some commodity exporters: demand for some commodities has failed to keep pace with growth in global incomes. And nobody will ever know what would have happened over the past few decades if all the developing countries had promoted trade more vigorously, because they didn't. But there are good practical reasons to regard the pessimism argument, as applied to poor-country exports in general, as wrong.

The developing countries as a group may be enormous in terms of geography and population, but in economic terms they are small. Taken together, the exports of all the world's poor and middle-income countries (including comparative giants such as China, India, Brazil and Mexico, big oil exporters such as Saudi Arabia, and large-scale manufacturers such as South Korea, Taiwan and Malaysia) represent only about 5% of global output. This is an amount roughly equivalent to the GDP of Britain. Even if growth in the global demand for imports were somehow capped, a concerted export drive by those parts of the developing world not already engaged in the effort would put no great strain on the global trading system.

In any event, though, the demand for imports is not capped. In effect, export pessimism involves a fallacy of its own—a “lump-of-trade” fallacy, akin to the idea of a “lump of labour” (whereby a growing population is taken to imply an ever-rising rate of unemployment, there being only so many jobs to go round). The overall growth of trade, and the kinds of product that any particular country may buy or sell, are not pre-ordained. As Mr Bhagwati and Mr Srinivasan argued in a recent review of the connections between trade and development, forecasts of the poor countries' potential to expand their exports have usually been too low, partly because forecasters concentrate on existing exports and neglect new ones, some of which may be completely unforeseen. Unexpected shifts in the pattern of output have often proved very important.

Pessimists also make too little of the scope for intra-industry specialisation in trade, which gives developing countries a further set of new opportunities. The same goes for new trade among developing countries, as opposed to trade with the rich world. Often, as developing countries grow, they move away from labour-intensive manufactures to more sophisticated kinds of production: this makes room in the markets they previously served for goods from countries that are not yet so advanced. For example, in the 1970s, Japan withdrew from labour-intensive manufacturing, making way for exports from the East Asian tigers. In the 1980s and 1990s, the tigers did the same, as China began moving into those markets. And as developing countries grow by exporting, their own demand for imports rises.

It is one thing to argue that relying on trade is likely to be self-defeating, as the export pessimists claim; it is another to say that trade actually succeeds in promoting growth. The most persuasive evidence that it does lies in the contrasting experiences from the 1950s onwards of the East Asian tigers, on one side, and the countries that chose to discourage trade and pursue “import-substituting industrialisation” (ISI) on the other, such as India, much of Latin America and much of Africa.

Years ago, in an overlapping series of research projects, great effort went into examining the developing countries' experience with trade policy during the 1950s, 60s and early 70s. This period saw lasting surges of growth without precedent in history. At the outset, South Korea, for instance, was a poor country, with an income per head in 1955 of around $400 (in today's prices), and such poor economic prospects that American officials predicted abject and indefinite dependence on aid. Within a single generation it became a mighty exporter and world-ranking industrial power.

Examining the record up to the 1970s, and the experience of development elsewhere in East Asia and other poor regions of the world, economists at the OECD, the World Bank and America's National Bureau of Economic Research came to see the crucial importance of “outward orientation”—that is, of the link between trade and growth. The finding held across a range of countries, regardless of differences in particular policies, institutions and political conditions, all of which varied widely. An unusually impressive body of evidence and analysis discredited the ISI orthodoxy and replaced it with a new one, emphasising trade.

The trouble with ISI

What was wrong with ISI, according to these researchers? In principle, nothing much; the problems arose over how it worked in practice. The whole idea of ISI was to drive a wedge between world prices and domestic prices, so as to create a bias in favour of producing for the home market and therefore a bias against producing for the export market. In principle, this bias could be modest and uniform; in practice, ISI often produced an anti-export bias both severe and wildly variable between industries. Managing the price-rigging apparatus proved too much for the governments that were attempting it: the policy produced inadvertently large and complex distortions in the pattern of production that often became self-perpetuating and even self-reinforcing. Once investment had been sunk in activities that were profitable only because of tariffs and quotas, any attempt to remove those restrictions was strongly resisted.

ISI also often had an even more pernicious consequence: corruption. The more protected the economy, the greater the gains to be had from illicit activity such as smuggling. The bigger the economic distortions, the bigger the incentive to bribe the government to tweak the rules and tilt the corresponding pattern of surpluses and shortages. Corruption and controls go hand in hand. ISI is not the only instance of this rule in the developing countries, but it has proved especially susceptible to shady practices.

Corruption and market-suppressing controls go hand in hand

Today, developing-country governments are constantly, and rightly, urged to battle corruption and establish the rule of law. This has become a cliché that all sides in the development debate can agree on. But defeating corruption in an economy with pervasive market-suppressing controls, where the rewards to illegality are so high, is extraordinarily hard. This is a connection that people who favour closed or restricted markets prefer to ignore. Limited government, to be sure, is not necessarily clean; but unlimited government, history suggests, never is.

Remember, remember

On the whole, ISI failed; almost everywhere, trade has been good for growth. The trouble is, this verdict

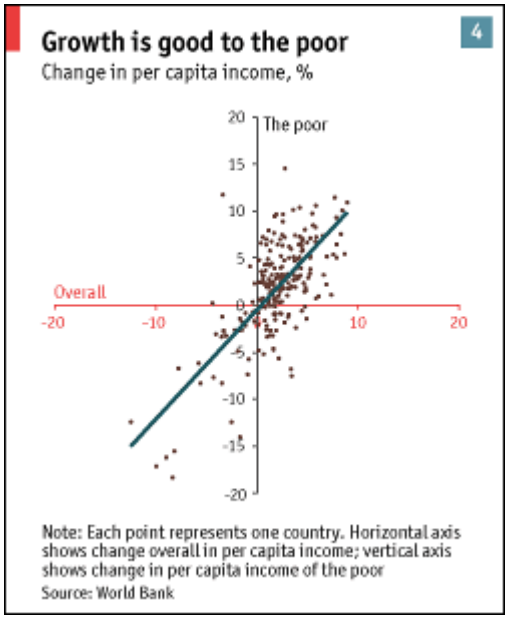
was handed down too long ago. Economists are notoriously ignorant of even recent economic history. The lessons about what world markets did for the tigers in the space of few decades, and the missed opportunities of, say, India (which was well placed to achieve as much), have already been forgotten by many. The East Asian financial crisis of 1997-98 also helped to erase whatever lessons had been learned. And yet the prosperity of East Asia today, crisis and continuing difficulties notwithstanding, bears no comparison with the economic position of India, or Pakistan, or any of the other countries that separated themselves for so much longer from the international economy.

By and large, though, the governments of many developing countries continue to be guided by the open-market orthodoxy that has prevailed since the 1980s. Many want to promote trade in particular and engagement with the world economy in general. Even some sceptics might agree that trade is good for growth—but they would add that growth is not necessarily good for poor workers. In fact, it is likely to be bad for the poor, they argue, if the growth in question has been promoted by trade or foreign capital.

Capital inflows, they say, make economies less stable, exposing workers to the risk of financial crisis and to the attentions of western banks and the International Monetary Fund. Also, they argue, growth that is driven by trade or by FDI gives western multinationals a leading role in third-world development. That is bad, because western multinationals are not interested in development at all, only in making bigger profits by ensuring that the poor stay poor. The proof of this, say sceptics, lies in the evidence that economic inequality increases even as developing countries (and rich countries, for that matter) increase their national income, and in the multinationals' direct or indirect use of third-world sweatshops. So if workers' welfare is your main concern, the fact that trade promotes growth, even if true, is beside the point.

Yet there is solid evidence that growth helps the poor. Developing countries that have achieved sustained and rapid growth, as in East Asia, have made remarkable progress in reducing poverty. And the countries where widespread poverty persists, or is worsening, are those where growth is weakest, notably in Africa. Although economic policy can make a big difference to the extent of poverty, in the long run growth is much more important.

It is sometimes claimed that growth is less effective in raising the incomes of the poor in developing countries than in rich countries. This is a fallacy. A recent study confirms that, in 80 countries across the world over the past 40 years, the incomes of the poor have risen one for one with overall growth (see chart 4).



If all this is true, why does global income inequality seem to be widening? First, the evidence is not at all clear-cut. Much depends on how you make your comparisons. An overall comparison of country aggregates—comparing rich countries with poor countries—is generally more encouraging than a comparison of the richest 10% of people in the world with the poorest 10%. In 1975, America's income per head was 19 times bigger than China's ($16,000 against $850); by 1995, the ratio had fallen to six ($23,000 against $3,700). On the other hand it is true that Africa's income per head is rising more slowly than America's: as a result, their income-gap ratio has increased, from 12 in 1975 to 19 in 1995. But it would be odd to blame globalisation for holding Africa back. Africa has been left out of the global economy, partly because its governments used to prefer it that way. China has embraced the global economy with a vengeance—and see how well it has done.

Better than nothing

Statistical difficulties aside, suppose it were true that global inequality is increasing. Would that be a terrible indictment of globalisation, as sceptics seem to suppose? Perhaps not. It would be disturbing, and extremely surprising, if poor countries engaged in globalisation were failing to catch up—but they aren't, as China and many other avid globalisers show. It would also be disturbing if inequality across the world as a whole were rising because the incomes of the poorest were falling in absolute terms, rather than merely in relative terms—but this is extremely rare. Even in Africa, which is doing so badly in relative terms, incomes have been rising and broader measures of development have been getting

better. It may be too little, but it is not nothing, merely because other countries have been doing better.

The sceptics are right to be disturbed by sweatshops, child labour and other gross abuses. But the problem is poverty, not globalisation

The sceptics are right to be disturbed by sweatshops, child labour, bonded labour and the other gross abuses that go on in many poor countries (and in the darkest corners of rich ones, too). But what makes people vulnerable to these practices is poverty. It is essential to ask if remedial measures proposed will reduce poverty: otherwise, in attacking the symptoms of the problem, you may be strengthening their underlying cause. It is one thing for the sceptics to insist, for instance, that child labour be prohibited; it is quite another to ensure that the children concerned go to school instead, rather than being driven to scrape a living in even crueller conditions.

The barriers to trade that many sceptics call for seem calculated to make these problems worse. Some sceptics want, in effect, to punish every export worker in India for the persistence of child labour in parts of the Indian economy. This seems morally indefensible as well as counter-productive in economic terms. The same goes for the campaign to hobble the multinationals. The more thoroughly these companies penetrate the markets of the third world, the faster they introduce their capital and working practices, the sooner poverty will retreat and the harder it will be for such abuses to persist.

This is not to deny that the multinationals are in it for the money—and will strive to hire labour as cheaply as they can. But this does not appear to be a problem for the workers who compete to take those jobs. People who go to work for a foreign-owned company do so because they prefer it to the alternative, whatever that may be. In their own judgment, the new jobs make them better off.

The lure of multinationals 5

Average wage paid by foreign affiliates and average domestic manufacturing wage by host-country income, 1994

	All countries	High-income	Middle-income	Low-income
Average wage paid by affiliates, $'000	15.1	32.4	9.5	3.4
Average domestic manufacturing wage, $'000	9.9	22.6	5.4	1.7
Ratio	1.5	1.4	1.8	2.0

Source: Edward M. Graham, Institute for International Economics

But suppose for the moment that the sceptics are right, and that these workers, notwithstanding their own preferences, are victims of exploitation. One possibility would be to encourage foreign firms to pay higher wages in the third world. Another course, favoured by many sceptics, is to discourage multinationals from operating in the third world at all. But if the aim is to help the developing-country workers, this second strategy is surely wrong. If multinationals stopped hiring in the third world, the workers concerned would, on their own estimation, become worse off.

Compared with demands that the multinationals stay out of the third world altogether, the idea of merely shaming them into paying their workers higher wages seems a model of logic and compassion. Still, even this apparently harmless plan needs to be handled cautiously.

The question is, how much more is enough? At one extreme, you could argue that if a multinational company hires workers in developing countries for less than it pays their rich-country counterparts, it is guilty of exploitation. But to insist on parity would be tantamount to putting a stop to direct investment in the third world. By and large, workers in developing countries are paid less than workers in rich countries because they are less productive: those workers are attractive to rich-country firms, despite their lower productivity, because they are cheap. If you were to eliminate that offsetting advantage, you would make them unemployable.

Of course you could argue that decency merely requires multinationals to pay wages that are “fair”, even if not on a par with wages in the industrial countries. Any mandatory increase in wages runs the risk of reducing the number of jobs created, but you could reply that the improvement in welfare for those who get the higher pay, so long as the mandated increase was moderate and feasible, would outweigh that drawback. Even then, however, two difficult questions would still need to be answered. What is a “fair” wage, and who is to decide?

What fairness requires

A “fair” wage can be deduced, you might argue, from economic principles: if workers are paid a wage that is less than their marginal productivity, you could say they are being exploited. Some sceptics regard it as obvious that third-world workers are being paid less than this. Their reasoning is that such workers are about as productive as their rich-country counterparts, and yet are paid only a small fraction of what rich-country workers receive. Yet there is clear evidence that third-world workers are not as productive as rich-country workers. Often they are working with less advanced machinery; and their productivity also depends on the surrounding economic infrastructure. More tellingly, though, if poor-country workers were being paid less than their marginal productivity, firms could raise their profits by hiring more of them in order to increase output. Sceptics should not need reminding that companies always prefer more profit to less.

Productivity aside, should “good practice” require, at least, that multinationals pay their poor-country employees more than other local workers? Not necessarily. To hire the workers they need, they may not have to offer a premium over local wages if they can provide other advantages. In any case, lack of a premium need not imply that they are failing to raise living standards. By entering the local labour market and adding to the total demand for labour, the multinationals would most likely be raising wages for all workers, not just those they hire.

In fact, though, the evidence suggests that multinationals do pay a wage premium—a reflection, presumably, of efforts to recruit relatively skilled workers. Table 5 shows that the wages paid by foreign affiliates to poor-country workers are about double the local manufacturing wage; wages paid by affiliates to workers in middle-income countries are about 1.8 times the local manufacturing wage (both calculations exclude wages paid to the firms' expatriate employees). The numbers come from calculations by Edward Graham at the Institute for International Economics. Mr Graham cites other research which shows that wages in Mexico are highest near the border with the United States, where the operations of American-controlled firms are concentrated. Separate studies on Mexico, Venezuela, China and Indonesia have all found that foreign investors pay their local workers significantly better than other local employers.

Despite all this, you might still claim that the workers are not being paid a “fair” wage. But in the end, who is to make this judgment? The sceptics distrust governments, politicians, international bureaucrats and markets alike. So they end up appointing themselves as judges, overruling not just governments and markets but also the voluntary preferences of the workers most directly concerned. That seems a great deal to take on.

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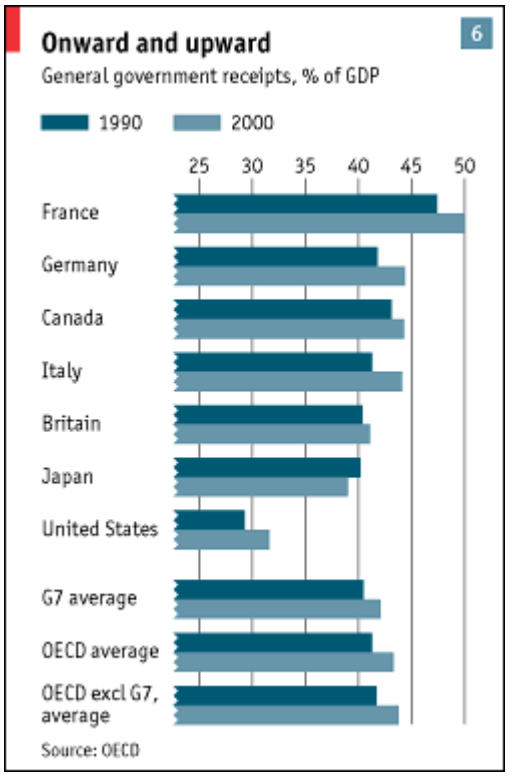
Is government disappearing?

Sep 27th 2001
From The Economist print edition

Not as quickly as one might wish

ECONOMISTS are often accused of greeting some item of news with the observation, “That may be so in practice, but is it true in theory?” Sceptics too seem much more interested in superficially plausible theories about the diminishing power of the state than in the plain facts.

In practice, though perhaps not in theory, governments around the world on average are now collecting slightly more in taxes—not just in absolute terms, but as a proportion of their bigger economies—than they did ten years ago. This is true of the G7 countries, and of the smaller OECD economies as well (see chart 6). The depredations of rampant capitalists on the overall ability of governments to gather income and do good works are therefore invisible. These findings are so strange in theory that many economic analysts have decided not to believe them.



Tax burdens vary a lot from country to country—something else which is wrong in theory. Despite the variations, governments in all the advanced economies are well provided for. The United States is invoked by some European anti-globalists as the land of naked capitalism, the nadir of “private affluence and public squalor” to which other countries are being driven down. Well, its government collected a little over 30% of GDP in taxes last year: an average of some $30,000 per household, adding up to roughly $3 trillion. This is a somewhat larger figure than the national income of Germany, and it goes a long way if spent wisely.

At the other extreme is Sweden, despite its celebrated taxpayer revolt of the early 1990s. Last year its taxes came to 57% of GDP, a savage reduction of three percentage points since 1990. Next comes Denmark, on 53%, fractionally higher than in 1990. And here's a funny thing. Sweden and Denmark are among the most open economies in the world, far more open than the United States. Denmark's ratio of imports to national income is 33%, compared with America's 14%. And in common with other advanced economies, neither of these Scandinavian countries has capital controls to keep investment penned in.

Harvard's Dani Rodrik, one of the more careful and persuasive globalisation sceptics, has written: “Globalisation has made it exceedingly difficult for government to provide social insurance...At present, international economic integration is taking place against the background of receding governments and diminished social obligations. The welfare state has been under attack for two decades.” Sweden, admittedly, is reeling, its government now able to collect only 57% of GDP in tax. But plucky Denmark is resisting these attacks well, and so is most of the rest of Europe.

Money isn't everything

Even if taxes were falling precipitously, it would be absurd to claim, as many globalisation sceptics do,

that companies are nowadays more powerful than governments. It is routine to be told, as in “The Silent Takeover”, a new book by a Cambridge University academic, Noreena Hertz, things like this: “51 of the 100 biggest economies in the world are now corporations.” Quite what that implies is never explained: readers are invited to draw their own conclusion about the relative power of governments and companies.

Before you even think about whether it makes sense to weigh corporate power against state power, you can see that this particular comparison, which measures the size of companies by their sales, is bogus. National income is a measure of value added. It cannot be compared with a company's sales (equal to value added plus the cost of inputs). But even if that tiresome, endlessly repeated error were corrected, there would be no sense in comparing companies with governments in terms of their power over people.

The power of even the biggest companies is nothing compared with that of governments

The power of even the biggest companies is nothing compared with that of governments—no matter how small or poor the country concerned. The value added of Microsoft is a little over $20 billion a year, about the same as the national income of Uruguay. Does this make it remotely plausible that Bill Gates has more sway over the people of Uruguay than their government does? Or take Luxembourg—another small economy with, presumably, a correspondingly feeble state. Can Microsoft tax the citizens of Luxembourg (whose government collected 45% of GDP from them last year), conscript them if it has a mind to, arrest and imprison them for behaviour it disapproves of, or deploy physical force against them at will? No, not even using Windows XP.

But those are specious comparisons, you might reply. Of course Bill Gates is less powerful than the government of Uruguay in Uruguay, but Mr Gates exercises his power, such as it is, globally. Well then, where, exactly, is Mr Gates supposed to be as powerful in relation to the government as the alarming comparison between value added and national income implies? And if Bill Gates does not have this enormous power in any particular country or countries, he does not have it at all. In other words, the power that Mr Gates exercises globally is over Microsoft. Every government he ever meets is more powerful than he is in relation to its own citizens.

In a war between two countries, national income is relevant as a measure of available resources. If companies raised armies and fought wars, their wealth would count for something. But they don't, and couldn't: they lack the power. Big companies do have political influence. They have the money to lobby politicians and, in many countries, to corrupt them. Even so, the idea that companies have powers over citizens remotely as great as those of governments—no matter how big the company, no matter how small or poor the country—is fatuous. Yet it is never so much as questioned by anti-globalists.

Any power to tax, however limited, gives a country more political clout than Microsoft or General Electric could dream of. But how can a small, exceptionally open economy such as Denmark manage to collect more than 50% of GDP in taxes, in utter defiance of the logic of global capitalism? The answer seems inescapable: Denmark no longer exists, and questions are starting to be asked about the existence of many other European countries. At least, that is how it looks in theory; in practice, the theory needs to be looked at again.

The limits of government

The alleged squeeze on government arises from the fact that, in a world of integrated economies, again in Mr Rodrik's words, “owners of capital, highly skilled workers, and many professionals...are free to take their resources where they are most in demand.” The people Mr Rodrik refers to have high incomes. Through the taxes they pay, they make an indispensable contribution to the public finances. If economic integration allows capital and skills to migrate to low-tax jurisdictions, the tax base will shrink. Governments will find themselves unable to finance social programmes, safety nets or redistribution of income. Anticipating this flight of capital and skills, governments have to cut taxes and dismantle the welfare state before the migration gets under way. Markets triumph over democracy.

That is the theory. Experience largely refutes it, but it is not entirely wrong. In a variety of ways, economic integration does put limits on what governments can do. However, some of those constraints are eminently desirable. Integration makes it harder to be a tyrant. Governments have been known to oppress their subjects. Oppression is more difficult with open borders: people can leave and take their savings with them. In such cases, global markets are plainly an ally of human rights.

The affinity of totalitarianism and economic isolation was obvious in the case of the Soviet Union and communist Eastern Europe; it is still plain today in the case of North Korea, say. But democracies are capable of oppression too. It would therefore be wrong to conclude that integration is undesirable merely because it limits the power of government, even if the government concerned is democratic. One needs to recognise that some constraints on democracy are desirable, and then to ask whether the constraints imposed by markets are too tight.

These issues are rarely, if ever, addressed by the critics of globalisation: it is simpler to deplore the notion of “profits before people”. The sceptics either insist, or regard it as too obvious even to mention, that the will of the people, democratically expressed, must always prevail. This is amazingly naive. Even the most elementary account of democracy recognises the need for checks and balances, including curbs on the majoritarian “will of the people”. Failing those, democracies are capable of tyranny over minorities.

The sceptics are terribly keen on “the people”. Yet the idea that citizens are not individuals with different goals and preferences, but an undifferentiated body with agreed common interests, defined in opposition to other monolithic interests such as “business” or “foreigners”, is not just shallow populism, it is proto-fascism. It is self-contradictory, as well. The sceptics would not hesitate to call for “the people” to be overruled if, for instance, they voted for policies that violated human rights, or speeded the extermination of endangered species, or offended against other values the sceptics regard as more fundamental than honouring the will of the majority.

The possibility that people might leave is not the only curb that economic integration puts on government. The global flow of information, a by-product of the integration of markets, also works to that effect. It lets attention be drawn to abuses of all kinds: of people especially, but also of the environment or of other things that the sceptics want to protect. Undeniably, it also fosters a broader kind of policy competition among governments. This works not through the sort of mechanical market arbitrage that would drive down taxes regardless of what citizens might want, but through informing voters about alternatives, thus making them more demanding.

The fashion for economic liberalisation in recent years owes something to the remarkable success of the American economy during the 1990s: a success which, thanks to globalisation, has been seen and reflected upon all over the world. Growing knowledge about the West helped precipitate the liberation of Eastern Europe. But information of this kind need not always favour the market. For instance, the failure of the American government to extend adequate health care to all its citizens has been noticed as well, and voters in countries with universal publicly financed health-care systems do not, on the whole, want to copy this particular model. The global flow of knowledge creates, among other things, better-informed voters, and therefore acts as a curb on government power. This does nothing but good.

The anti-globalists themselves, somewhat self-contradictorily, use the information-spreading aspect of globalisation to great effect. Organising a worldwide protest movement would be much harder without the World Wide Web, but the web itself is merely one dimension of globalisation. The economic integration that sceptics disapprove of is in many ways necessary for effective resistance to the more specific things they object to—not all of which, by any means, are themselves the products of globalisation.

Still, all this is to acknowledge that economic integration does limit the power of government, including democratic government. The question is whether it limits it too much, or in undesirable ways. So far as far public spending is concerned, the answer seems clear. Given that even in conditions of economic integration people are willing to tolerate tax burdens approaching 60% of GDP, and that tax burdens of between 40% and 55% of GDP are routine in industrial economies other than the United States, the limits are plainly not that tight. These figures say that democracy has plenty of room for manoeuvre.

The mystery of the missing tax cut

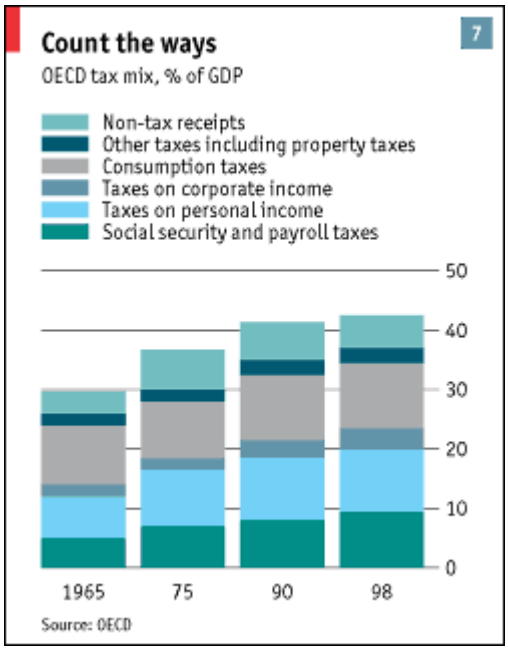
One puzzle remains: why are taxes not coming down? There are several answers. One is that international integration is far from complete, and is likely to remain so. Technology has caused distance to shrink, but not to disappear. National borders still matter as well, even more than mere distance, and far more than all the interest in globalisation might lead you to expect. For all but the smallest economies, trade and investment are still disproportionately intranational rather than international. Especially in the developed world, borders still count not so much because of overt protectionist barriers, but because countries remain jurisdictionally and administratively distinct. This is not likely to change in

the foreseeable future.

For instance, if a supplier defaults on a contract to sell you something, it is much easier to get legal redress if your seller is in the same country (and subject to the same legal authority) than it would be if you had to sue in a foreign court. Because of these difficulties in contracting, trading across borders still calls for much more trust between buyers and sellers than trading within borders—so much so as to rule out many transactions. This remains true even in systems such as the European Union's, where heroic efforts have been made to overcome inadvertent obstacles to trade, suggesting that they will prove even more durable everywhere else.

You would expect the international mobility of capital to be especially high, given that the costs of physical transporting the stuff are virtually zero, yet it is surprising just how relatively immobile even capital remains. In the aggregate, the flow of capital into or out of any given country can be thought of as balancing that country's saving and investment. If the country invests more than it saves (that is, if it runs a current-account deficit), capital flows in; if it saves more than it invests (a current-account surplus), the country must lend capital to the rest of the world. Perfect capital mobility would imply that, country by country, national saving and investment would move freely in relation to each other. Very large inflows or outflows of capital in relation to national income would be the order of the day. In fact they are not. Nowadays, a surplus or deficit of just a few percentage points of GDP is regarded as big.

Still, capital is much more mobile than labour—and mobile enough, to be sure, to have given rise to some tax competition among governments. So far this competition has affected the structure of tax codes rather than overall tax burdens; total yields have been unaffected. In an effort to attract inflows of capital, and especially inflows of foreign direct investment, governments have been lowering their tax rates for corporate income and raising them for personal income, or relying more on a variety of indirect taxes, or both (see chart 7). But it is easy to exaggerate the extent even of this structural shift, never mind the effect on total taxation. This is because taxes on corporate income were small to begin with, so not much was at stake. In fact, heavy reliance on corporate taxes is bad policy even in a closed economy. Indeed, in a closed economy, you can make a respectable case on efficiency grounds for excluding corporate income from taxes altogether.



Taxes on company profits, the argument goes, are taxes on shareholders' income—ultimately, that is, taxes on a particular category of personal income. In the end, although it is politically convenient to pretend otherwise, “the people” pay all the taxes: companies are mere intermediaries. There is no reason to tax the income people receive as shareholders any differently from the income they receive as owners of bank deposits or as workers. In a closed economy, you might as well abolish the corporate-income tax and instead tax profits when they turn up as dividends in the incomes of individual taxpayers: it is simpler, and it is less likely to affect investment decisions in unintended ways.

In an open economy, however, company ownership is to some extent in the hand of foreigners, not just the citizens of the country where the company is based. This makes it more tempting to tax corporate income, because this allows the government to bring foreigners within the scope of its tax base. Seen this way, it is odd to blame globalisation for downward pressure on corporate-tax rates. Were it not for globalisation, there would be no reason to have corporate taxes in the first place. But it is true that once you are collecting corporate taxes, greater capital mobility limits your take. Economic integration rationalises, and at the same time limits, reliance on corporate-income taxes. The issue is subtler than it seems.

Staying put

But what matters far more than corporate tax policy is that most people, skilled as well as unskilled, are reluctant to move abroad. Since workers tend to stay put, governments can tax them at surprisingly high rates without provoking flight. In all but extreme cases, the democratic constraint (the need to secure a broad measure of popular support for tax increases) binds governments long before the economic constraint imposed by international integration (the risk that groups facing very high taxes will leave). In

the case of taxes on profits, it is true that the economic constraint will bind before the democratic one, and that globalisation serves to tighten the economic constraint further—but this does not matter. There is no need for high taxes on profits if people are willing to hand over 50% or more of what they produce in the form of taxes on income and consumption.

To simple-minded believers in the most desiccated branch of neoclassical economics, all this may seem surprising. Their theories regard people as “rational economic men”, narrow utility-maximisers with no ties to family, place or culture. Presumably, these ciphers would shop around for low-tax jurisdictions. Oddly, the same benighted view of human nature must be shared by many globalisation sceptics—otherwise, why would they fear taxpayer flight on a scale sufficient to abolish the European welfare state? But in real life, it is better to take a fuller, broader view of the human condition. Since people seem to choose to be tied down, indeed to relish it, governments, within broad limits, can carry on taxing them regardless of globalisation. If it seems prudent to cut taxes on profits in order to attract inflows of foreign investment, no problem. Taxes on people will still be sufficient to finance generous public spending of every kind.

Be very afraid

Many anti-globalists have strangely little confidence in the merits of the policies they are anxious to sustain. Fearing what may be lost if globalisation continues uncurbed, Mr Rodrik writes:

> If it was the 19th century that unleashed capitalism in its full force, it was the 20th century that tamed it and boosted its productivity by supplying the institutional underpinnings of market-based economies. Central banks to regulate credit and the supply of liquidity, fiscal policies to stabilise aggregate demand, antitrust and regulatory authorities to combat fraud and anti-competitive behaviour, social insurance to reduce lifetime risk, political democracy to make the above institutions accountable to the citizenry—these were all innovations that firmly took root in today's rich countries only during the second half of the 20th century. That the second half of the century was also a period of unprecedented prosperity for Western Europe, the United States, Japan and some other parts of East Asia is no coincidence. These institutional innovations greatly enhanced the efficiency and legitimacy of markets and in turn drew strength from the material advancement unleashed by market forces...The dilemma that we face as we enter the 21st century is that markets are striving to become global while the institutions needed to support them remain by and large national...The desire by producers and investors to go global weakens the institutional base of national economies.

The argument, presumably, is that international capital will flow away from countries with the high public spending and taxes that these highly developed institutions involve. One answer is that international investment, as already noted, is much less important in most countries than domestic investment. But a more fundamental question is this: why should foreign capital flow away from countries that have equipped themselves with these institutions, if, as Mr Rodrik emphasises, those arrangements have “boosted...productivity” and “greatly enhanced the efficiency...of markets”—so much so that the most ambitious period of national institution-building was also a time of growing and “unprecedented” prosperity for the nations that joined in?

If public spending boosts productivity, then competition among governments for inward investment is likely to favour more public spending (and the taxes needed to pay for it), not less. Suppose, as seems plausible, that public spending on education raises productivity by increasing the supply of skilled workers. Then you would expect international investment to be drawn to countries that invest heavily in top-quality schools and universities. Suppose, as may also be true, that public spending on social programmes such as health and welfare raises productivity, by producing a healthier and more contented workforce, with better labour relations and greater labour mobility. If so, again international capital will be drawn to countries that spend money on those things. Globalisation, surely, will not frown on policies whose net effect is to foster productivity and efficiency.

But what about policies that do not serve those goals? Many would argue, for instance, that welfare policies, especially if too generous, encourage idleness and reduce economy-wide productivity. Suppose that is true. Also suppose that, knowing it to be true, most people want such policies anyway. You might feel that they are entitled to that opinion, and in a democracy they are entitled to get their way. Another example might be policies to limit working hours. Suppose that they reduce productivity, but that people vote for them anyway. Must globalisation overrule democracy?

Globalisation v democracy

The answer even in this case is no—and to see why is to understand why so many of the fears about globalisation and democracy are groundless. Policies that reduce productivity do, in the first instance, cut a country's feasible standard of living, narrowly defined in terms of GDP per head. But what happens after that? If a country that is open to international trade and capital flows adopts some such policies, perhaps on the ground that they will raise living standards according to some broader definition, wages and profits will fall relative to what they would otherwise have been. Next, investment will fall and the capital stock will shrink, again compared with what they would otherwise have been. This will continue until the scarcity of capital drives the rate of profit back up, at the margin, to the rate prevailing in the global capital market.

All this time the economy will grow more slowly than if the policies had not been followed. Once the economy has adjusted, however, it remains as “competitive” as it was at the outset: lower wages have restored labour costs per unit of output, and a smaller stock of capital has restored the return on capital. The economy has grown more slowly for a spell. It is less prosperous than it would have been. But in due course, once wages and profits have adjusted, the economy will again be as attractive, or unattractive, to foreign investors as it was at the outset. The government's adoption of policies that compromise efficiency is not punished by excommunication from the global economy, or with an accelerating spiral of decline; the only penalty is compromised efficiency and lower measured incomes, which is what the country chose in the first place.

Would the economy have fared any better without globalisation?

Would the economy have fared any better without globalisation? Had it been closed to international flows of goods and capital, could it have adopted those productivity-cutting policies and paid no price at all? The answer is no. Even in a closed economy, policies that reduce productivity would cause wages and profits to fall, as in the open-economy case. The return on capital would be lower, so saving and investment would decline, relative to what they would have been (there would be no cross-border capital flows in this case, so saving and investment must always be equal). The capital stock would shrink and growth would be held back until the scarcity of capital drove the return back up. As in the open-economy case, the result would be a spell of slower growth and a standard of living permanently lower than it would otherwise have been.

The main difference is probably that in the closed-economy case, the losses would be subtracted from an economy that is already very much poorer than its open-economy counterpart, because it is closed. Conceivably, this would make further losses politically easier to sustain. But that is the most you can say in defence of the view that globalisation forbids social policies which jeopardise productivity. “Stay poor, because once you start to get rich you may find that you like it.” Not exactly compelling, is it?

You might well conclude from all this that globalisation, if anything, will lead to higher rather than lower social spending. As argued earlier, globalisation raises aggregate incomes but at the same time increases economic insecurity for certain groups. Both of these consequences tend to raise social spending. Generous social spending is a “superior good”: as countries grow richer, they want to spend more of their incomes on it, and can afford to. At the same time, quite separately, greater economic insecurity directly spurs demand for social spending.

Given that globalisation increases the demand for social spending; given that it does not rule out any decision to increase such spending which harms productivity, any more than a closed economy would; given that increases in social spending which raise productivity will be rewarded with inflows of capital; given all this, should globalisation and the generous social spending that democracies favour not go hand in hand? They should, and indeed rising social spending alongside faster, deeper globalisation is exactly what the figures for the past several decades show.

Governments in rich countries need to look again at their social policies, partly to make sure that temporary and longer-term losers from globalisation, and from economic growth in general, get well-designed help. But there is no reason whatever to fear that globalisation makes social policies more difficult to finance. In the end, by raising incomes in the aggregate, it makes them easier to finance. It creates additional economic resources, which democracies can use as they see fit.

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A crisis of legitimacy

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People are fed up with politics. Do not blame globalisation for that

IT WOULD be wrong to say that economic integration neuters democracy or, more specifically, places any real constraints on the welfare state. Yet the view that globalisation is hollowing out politics seems to be almost universal among the economic and political commentariat. The fears expressed go wider than the implications of globalisation for the welfare state. Opinion polls in western democracies show disaffection with the political process. That, the columnists say, is because globalisation has made politics much less important. Fewer people are turning out to vote in elections these days. It hardly seems worth bothering, the argument runs, now that multinational companies rather than elected governments are calling the shots. True or false?

In his best-selling book on globalisation, “The Lexus and the Olive Tree”, Thomas Friedman of the *New York Times* makes much of the “Golden Straitjacket”. That is what he calls the policies which, according to the current orthodoxy, are necessary to establish the markets' confidence in any particular economy and its government: balanced budgets, moderate taxes, light regulation, privatisation and so forth. Once a country puts on the Golden Straitjacket, Mr Friedman says:

> Two things tend to happen: your economy grows and your politics shrinks...The Golden Straitjacket narrows the political and economic choices of those in power to relatively tight parameters. That is why it is increasingly difficult these days to find any real differences between ruling and opposition parties in those countries that have put on the Golden Straitjacket. Once your country puts on the Golden Straitjacket, its political choices get reduced to Pepsi or Coke—to slight nuances of policy, slight alterations in design to account for local traditions, some loosening here or there, but never any major deviation from the core golden rules.

This argument is widely quoted and almost universally accepted. There can be no denying that the world has seen a striking convergence of economic ideology in the past decade or two. That makes Mr Friedman's argument seem plausible. But something else about it ought to arouse suspicion: advocates of globalisation and sceptics alike go along with it. Enthusiasts for globalisation (Mr Friedman among them) by and large think that the policies of the Golden Straitjacket are the right ones, and agree that your economy will indeed grow faster if you adopt them. Many sceptics are willing to concede this second point. The Golden Straitjacket may indeed make your economy grow faster—by the flawed and inequitable measures of free-market economics, at any rate—but in their view this gain cannot outweigh the loss of political sovereignty and democratic legitimacy that the straitjacket also entails.

The policies favoured by current orthodoxy do involve restraint—that much is true, and it makes the straitjacket metaphor apt. Balancing the budget is usually more difficult than letting public spending run ahead of taxes. From the government's point of view, deregulation, privatisation and so forth are also restricting rather than liberating: they mean doing less, whereas day-to-day political pressures usually urge governments to do more. But the crucial question that Mr Friedman's analysis leaves aside is whether or not these constraints are being imposed legitimately.

To talk of the narrowing of choices and the “shrinking of politics” implies that the process is anti-democratic. It need not be so. Voters everywhere may have come to prefer balanced budgets, moderate taxes, privatisation and the rest on their merits. If they have, the shrinking of politics around the current orthodoxy does not represent any weakening of democracy. If the voters decide to choose Pepsi or Coke, you might say, their choice has narrowed to Pepsi or Coke, until they choose next time.

On the other hand, questions of legitimacy certainly do arise if voters would rather not have balanced budgets, moderation in public spending and taxes, privatisation and so on—but are getting those policies anyway. And they also arise, you might argue, even if voters accept the straitjacket policies reluctantly, and only because forces more powerful than their governments have narrowed the range of choices before the electorate even comes to decide.

What about the voters?

Critics of globalisation make both arguments. The first, which says that voters are simply ignored, is unpersuasive. It is difficult to believe that if voters really did want big budget deficits, higher taxes, more public ownership of industry and so on, political parties would not seek to get elected—and succeed in getting elected—by offering those things. The second argument, which says that voters support the policies favoured by current orthodoxy but wish they did not have to, has real weight. The straitjacket policies are supported by most voters, it seems, but not with much enthusiasm. There is a recurring sense of bowing down to forces more powerful than liberal democracy—the markets, the multinationals, the WTO and the IMF. That disenchantment is in itself a kind of democratic failure.

Where does the blame for this lie? For the most part, not with globalisation as such—not with economic integration, not with markets, not with institutions like the Fund and the WTO—but with politicians. In all kinds of ways, again and again, governments and their political opponents have used the supposed demands of globalisation to deny responsibility. If you tell people you are helpless often enough, they will start to believe you.

One of the principal themes in western politics of the past ten or 15 years has been the “modernisation” of the left. Ex-socialist and moderate left-of-centre parties alike have moved to the centre, and in some cases past it. They have renounced outright egalitarianism, no longer advocate public ownership as an end in itself, seek opportunities for “partnership” with the private sector, prefer “conservative” macroeconomic policies, and favour moderation in taxes and public spending. Tony Blair's Labour government in Britain is probably the clearest case, but it is by no means unique in Europe. And something similar happened to America's Democrats under Bill Clinton. It was Mr Clinton, New Democrat, who duly signed the legislation “ending welfare as we know it”—terminating the federal government's commitment of 61 years' standing to provide cash assistance to the poor.

Is the realignment of the left connected to the acceleration of economic integration?

This realignment of the left has coincided over the past decade or so, it is pointed out, with an acceleration of economic integration. It is tempting to see, like Mr Friedman, a connection between the two trends—especially since the modernising left itself insists that there is one. “The world has changed,” Tony Blair tells his party's traditional supporters, “but our values have not.” In other words, if only we could, we would still like to do all the things leftist parties have traditionally done. We cannot, because the world now follows different rules. Today, governments need the co-operation of the global capital markets. Competition is fiercer than it has ever been before. We have to sound more like our conservative opponents—and the reason is globalisation.

But is it really? It seems unlikely. Globalisation may or may not be accelerating, but no particular turning point, so far as economic integration is concerned, coincides with the rather sudden repositioning of America's Democratic Party and the virtual disappearance, at about the same time, of Europe's classical left.

An embarrassing coincidence

Another event did coincide with these changes: the collapse of communism. However much the left in the West disavowed or even despised Soviet communism, that system had stood as a living, breathing alternative to the capitalist paradigm: a reminder that an alternative did exist. When that standard was torn down, it was a severe embarrassment. When, thanks to *glasnost*, the West found out exactly how disgusting communism in practice had been, the embarrassment deepened so much that most of the left's political vocabulary was discredited. These world-historical events were especially badly timed for the left: they seemed to seal the success that strident, iconic, right-of-centre governments in America, under Ronald Reagan, and Britain, under Margaret Thatcher, had already achieved.

The left was humiliated by association, found its values rendered deeply suspect, and suffered a

monumental crisis of confidence. Also, it went out of fashion. Subtle repositioning in America's case, outright reinvention in Britain's, and something in-between elsewhere in Western Europe, became a domestic political necessity. No doubt many of the reformers welcomed this opportunity to recast their parties along lines closer to their own beliefs. But for most of the party members and long-time supporters it was an extremely reluctant conversion.

How were the leaders to present—to market, as they now might say—their newly realigned parties, both to the members and to voters? Grand empty talk of a new “third way” was a telling sign of desperation. The leaders of the new left could hardly expect to retain the loyalty of traditionalists if they came out and said: “Most of what we used to assert is wrong. Now that we have been found out, we are going over to the other side. From now on we stand for a kinder, gentler, more compassionate sort of conservatism.” Instead, to appeal to centrist voters, while at the same time flattering traditionalists into believing that their ideas still prevailed, they put it another way: “The world has changed, our values have not.”

Was this nothing but a ruse? Globalisation, as already noted, has left the capacity of governments to gather taxes and pay for public spending essentially undiminished. But there are other kinds of constraint. It is often argued, for instance, that global capital markets nowadays stop governments running big budget deficits. Global capital will no longer tolerate public ownership of utilities or other monopolistic enterprises, it is said. And the need to keep companies internationally competitive leaves governments no choice but to dismantle health and safety regulation, or to ease up on environmental rules.

In reality, the global capital market makes it easier to run big budget deficits, because there is an infinitely larger pool of funds to tap. As for public ownership, on balance global capital doesn't much care. Investors lending to publicly owned enterprises may see advantages, in fact, notably government guarantees of the debt. China has many state-owned enterprises, and seems to have no trouble attracting inward investment.

Race to the bottom?

What about the regulatory race to the bottom? There has lately been a good deal of economic deregulation, it is true, aimed at spurring competition in finance especially. And deregulation of this sort, once you start, has a habit of leading to more deregulation. In this area, governments might be forgiven for feeling sometimes that they have started something they cannot stop or any longer control. But questions such as whether banks should be allowed to sell insurance, or how exactly financial institutions should be supervised, are not deeply ideological. Important as they are, these are technical issues.

Other kinds of regulation—for example, of health and safety in the workplace, terms of employment, product and environmental standards—have far more ideological content. Has globalisation led to a race to the bottom in this kind of regulation? There is little sign of it. The clear trend in rich and poor countries alike is for ever tighter regulation of this sort. If globalisation has started a race in these areas, it is to the top, not the bottom.

Where formerly left-of-centre parties have adopted soft-conservative policies—moderation in taxes and spending, “fiscal responsibility” and the rest—the reason cannot be globalisation. The reason, in fact, is democracy. These policies, for the moment, are popular. Globalisation has been a useful subterfuge for the left—and, it should be noted, for the right as well, albeit to a smaller extent. Conservatives too can compete for support in the centre by prating on about how such and such a tax must be cut for the sake of preserving competitiveness, rather than because low taxes are good in themselves. Just as the left has found, there is advantage in claiming that a policy you propose must be adopted because there is no choice.

If you believe that the realignment of the left was a good thing, you might feel that the globalisation subterfuge is a small price to pay for moving the parties intact to the centre, where they can do more good. But there is a price, and it may be higher than anybody realised. The denial of responsibility, the pretence that policies are dictated by global markets rather than chosen by elected governments, the refusal to consider alternatives—all these are profoundly corrosive of democracy.

The ex-left has repeated countless variations on its new slogan—the world has changed, our values have not—all over the industrialised world. Often, the right has joined in. This was bound to persuade many people that conventional politics is indeed a waste of time. That, in effect, is exactly what political leaders are saying.

When anti-capitalist protesters tried to disrupt a meeting of European Union leaders recently, Tony Blair was especially scathing, calling the rioters mindless thugs. No doubt he was right about many of them, but his contempt was nonetheless ironic. The protesters say that people have been disempowered by global capitalism. They are wrong, but politicians themselves played a large part in devising that specious theory. It seemed an innocent deception at the time, but the protesters' rage, and the support they receive from large parts of the public, suggest that it was a dangerous move for democracy.

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A plague of finance

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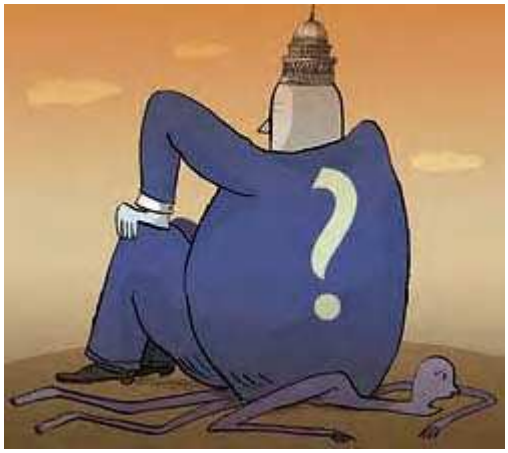
From The Economist print edition

Anti-globalists see the "Washington consensus" as a conspiracy to enrich bankers. They are not entirely wrong



WHEN they criticise globalisation, sceptics are not just talking about economic integration across borders, or about the particular economic policies, such as liberal rules on trade and international investment, that directly facilitate it. They have in mind a much larger set of economic nostrums and institutions: the policies of the "Washington consensus", as it is known, and the international bodies, notably the International Monetary Fund and the World Bank, that strive to put it into effect.

The term "Washington consensus" was coined by the economist John Williamson in 1989. He called it that because of the support it enjoyed from the American government and (not coincidentally) from the Fund and the Bank, the big Washington-based institutions. He said it stood for ten policies. Measures to promote trade and FDI were high on the list, but the new orthodoxy, as he described it, also ran to the following: fiscal discipline (ie, smaller budget deficits), fewer subsidies, tax reform, liberalised financial systems, competitive exchange rates, privatisation, deregulation and measures to secure property rights.

In the view of many sceptics, this broad "neo-liberal" agenda has been deliberately designed to serve the needs of the rich at the expense of the poor. The sceptics' thinking on trade and foreign investment has already been discussed; their view of the rest of the formula is just as scathing. Fiscal discipline, curbs on subsidies and increases in taxes—measures long emphasised by the IMF in its dealings with distressed developing-country borrowers—directly hurt the poor, they say. Privatisation, financial liberalisation and industrial deregulation work to the same effect, by delivering windfall profits to domestic and foreign speculators, by stripping the state of its assets and by weakening rules that protect consumers and workers from abuse.

Error and muddle have obscured valid criticisms of the "Washington consensus"

These policies are forced on poor-country governments regardless of their own views and priorities, incidentally undermining democracy in the third world. In the longer term, this kind of development—in effect, on terms dictated by the rich countries—saddles the developing countries with crippling debts. It also exposes them to the crazy fluctuations of the global business cycle. East Asia, one-time exemplar of the Washington model, discovered that to its cost; now Argentina, another darling of the Washington development establishment, is on the rack for the same reason. Insupportable debts and chronic instability worsen the developing countries' dependence on aid, and allow the IMF to tighten the screws even more vigorously next time, at the direction of American bankers. In every way, sceptics believe, the Washington consensus is a calculated assault on the weak.

Extreme as this caricature may be when taken as a whole, it contains some truths—which is why, for all its absurdity, it is recognisable. The idea that the Washington establishment is engaged in a deliberate conspiracy to oppress the third world may be nonsense, but there have been mistakes, big and small, and unintended consequences aplenty. The problem is that the valid criticisms are buried under a heap of error, muddle and deliberate distortion. The IMF, the Bank and America's Treasury Department would all feel much more threatened if the shards of intelligent criticism could be filtered from all the rubbish and gathered together.

Beware foreign capital

One of the clearest lessons for international economics in the past few decades, with many a reminder in the past few years, has been that foreign capital is a mixed blessing. This stricture does not apply so much to FDI because, unlike debt, FDI does not need to be serviced and cannot flee at short notice. As a result, providers of FDI themselves bear most of the financial risk attached to the investment, but this advantage comes at a price. Over the long term, FDI is a more expensive form of finance than debt because the outflow of remitted profits usually gives this kind of investor a bigger return than a foreign bank or bondholder could expect to receive. All the same, FDI is not only less risky for the host country, it is also more productive, as noted earlier, because of the technology and techniques that come with it. It is expensive from the host country's point of view, but good value.

Other forms of foreign capital, and especially short-term bank debt, have led many a developing country into desperate trouble. Because of the debt crisis, the 1980s were a lost decade for Latin America; today, in different ways, Argentina and Brazil are both in difficulty again because of debt. The financial crisis of the late 1990s set back even the East Asians, up to then the best-performing of all the developing countries. Why has this happened—and why so often?

Borrowers, obviously, have to take their share of the blame for borrowing too much, though that is rarely the whole explanation. Governments that borrow heavily in order to finance recklessly large budget deficits are plainly at fault. There was a lot of that in the 1970s and early 1980s. The case of corporate borrowers in developing countries is more complicated. They may sometimes borrow amounts which seem individually prudent given certain macroeconomic assumptions—such as no devaluation of the currency—but which become collectively insupportable if those assumptions turn out to be wrong. This happened in East Asia in the 1990s, with the further complication that much of the borrowing was channelled through domestic banks, meaning that the ultimate borrowers were unaware of the system-wide exchange-rate risk.

Sometimes, therefore, developing-country banks have been at fault as well—and their governments too, for failing to regulate them effectively. Some governments have also allowed, or actively encouraged, too much foreign borrowing by firms, with or without the intermediation of domestic banks and other financial institutions. Even some governments that have taken care to keep their own borrowing in check have been guilty of these failures of regulation and oversight.

But at least as much of the blame for the developing world's recurring debt traumas lies with rich-country lenders and, at one remove, rich-country governments. Modern banking operates, notoriously, under the persistent influence of moral hazard. This arises because deposit-taking banks are intrinsically fragile operations—and because governments are reluctant to let them fail. Banks are fragile because they promise depositors to repay deposits on demand and in full, even though they are unable to keep that promise if a significant number of depositors decide to exercise their right all at once. To avoid the risk of bank runs, which is high given the design of the contract with depositors, governments arrange deposit-insurance schemes, and other forms of assurance, including the doctrine of “too big to fail”.

There are good reasons for this. If a bank fails, it may take other banks and enterprises, not to mention depositors' savings, with it; the broader payments system may also be imperilled. Historically, bank failures are associated with economy-wide recessions; for example, they helped to bring on the Depression of the 1930s (which was the inspiration for the modern deposit-insurance model). But the upshot is that banks are systematically protected from the consequences of their reckless behaviour.

Modern banks keep a far smaller fraction of their deposits as reserves than their historical forebears. Depositors have no incentive to supervise the banks by keeping an eye on reserves or by withdrawing money from the ones that are taking too many risks: their deposits are protected in any case. And banks have a correspondingly big incentive to compete aggressively for deposits which they can lend at high interest rates to risky projects. It is a formula for ruin—and, despite the efforts of regulators to measure and curb those risks, it keeps on working exactly as you would expect. In almost every case of spectacular boom and bust in recent years, in rich and poor countries alike, an exaggerated cycle of banking greed and fear has been a principal cause.

Too big to fail

So when sceptics accuse rich-country governments of being mainly concerned with bailing out western banks when financial crisis strikes in the third world, they have a point. The pernicious logic of “too big to fail” applies in the international context as well as the domestic one. If you are going to go bust, make sure you are a big developing country rather than a small one, with debts large enough to threaten

catastrophic damage to America's financial system. That way you can be assured of prompt attention.

Until the intractable dilemmas of global bank regulation have been resolved—supposing they ever can be—the hazards of borrowing from abroad do argue for greater caution than poor-country borrowers have often used, or been advised to use by the IMF and the World Bank. The confidence with which the Fund and the Bank advised, or required, countries to abolish capital controls now looks misplaced in many cases.

The policy was doubtless well-intended. There is no question that moderate inflows of debt can speed development. This is why a good credit standing is a valuable asset for a developing country, and why too ready a willingness to default on debt usually proves self-defeating. But if bank regulation in rich countries leaves much to be desired, in many poor countries it is even worse. No doubt it would be best to bring financial regulation in developing countries up to the standard, such as it is, of regulation in America and Europe. But that is easier said than done. In the meantime, taxes or controls on short-term foreign-currency inflows, of the kind Chile has used with success, may well be better for some poor countries than the alternatives of, on the one hand, no inflows at all and, on the other, completely unrestricted inflows intermediated by a weakly or corruptly regulated domestic financial system.

In many other respects, however, the sceptics' attacks on the Fund and the Bank are ill-conceived. The IMF, especially, is criticised for sending its experts into developing countries and commanding governments to balance the budget in ways that assault the poor—by cutting spending on vital social services, ending subsidies or raising taxes on food and fuel, levying charges for use of water, and so on down the list of shame.

The sceptics' attacks on the Fund and the Bank are for the most part ill-conceived

Measures to curb budget deficits are often unavoidable by the time the Fund is called in. The only way to reduce a budget deficit is to raise taxes or cut public spending. In many developing countries, where tax systems are narrowly based and unsophisticated, governments may have few options in deciding how to go about it. It would not be in the political interests of the Fund or the Bank to recommend measures that fall heavily on the poor if there were an obvious alternative.

However, the Fund, especially, may have invited much of the criticism it receives in this respect because it specifies policy changes in such detail. The IMF should strenuously avoid letting itself be seen as running the country, giving the government instructions and telling workers and voters to get lost. On the other hand, many sceptics seem to be under the impression that all was well in the countries concerned until the Fund barged in. The Fund turns up only when things have already gone very wrong indeed—and only when the government in question has asked for its help. That last point is surely worthy of more attention than the sceptics pay to it. If governments find the Fund's conditions so oppressive, they always have the option of refraining from asking for its help.

Governments know that the alternative to the Fund's intervention would usually be an even sharper contraction of public spending (including on social services) and/or an increase in taxes (including on things the poor need to buy). By the time the IMF is called in, the question whether to curb government borrowing is not so much a matter of weighing, as sceptics suppose, the case for laisser faire against the demands of social justice. Often, in the good-faith judgment of the IMF's officials, it is just an inescapable necessity if the economy is to be stabilised. And at times of impending economic collapse, stabilisation is very much in the interests of the poor, who suffer most during slumps.

In fact, most of the policies of the Washington consensus serve, or are capable of serving, the interests of the poor directly, not merely by promoting growth. If governments have been at fault in defending that agenda, it has mainly been in failing to emphasise this. The centrepiece of these policies, fiscal discipline, is sometimes necessary to avert an economic calamity; but even in more normal times, the alternative to steady control of government borrowing is usually high inflation. That, all the evidence shows, hurts the poor more than anyone else.

As noted by Mr Williamson back in 1989, the consensus called not just for fewer subsidies, but for new priorities in public spending, especially more effective support for industry and more spending on education and health—priorities intended to help the poor which the Bank has tried hard to put into practice. The need to broaden the tax base, so as to support additional public spending without destabilising the economy, is another idea that favours the poor, because there is no other way to provide the resources necessary to pay for effective safety nets. Deregulation and improved property rights can also make a real difference to the poor. As the work of Hernando de Soto has shown, it is the poor who suffer most from obstacles to small-scale enterprise and insecure titles to land.

Many sceptics might warm to the Fund and the Bank if they paid more attention to the criticisms directed at the two institutions from the political right. Conservatives worry not so much because the Fund is too mean, or the Bank too keen on market economics, but rather the opposite: they complain that both are engaged in throwing good money after bad. Worse than that, critics on the right argue, the two institutions reward the bad policies that got the patients into trouble in the first place, thereby creating their own kind of moral hazard.

If the Fund and the Bank were simply shut down, as many sceptics and many conservatives would wish, the flow of resources to the developing countries would certainly diminish, at least in the short term. The world economy would be a harsher place for the poor countries. The conservatives argue, in effect, that this would be good for them in the longer term. Those sceptics who favour slower economic growth for the third world would also be gratified, presumably, if the Fund and the Bank packed up. But it is hard to see what those who are not opposed to development as such see in this course.

Trying to get it right

The IMF and the Bank have certainly made mistakes. They have had spells of over-confidence, though they cannot be accused of that at the moment. Noted scholars such as Joseph Stiglitz, a former chief economist at the World Bank, have criticised them for technical incompetence, and for theological devotion to discredited economic theories; but other economists have argued in their defence, saying, plausibly, that they have done their best in difficult circumstances. They have certainly neglected the importance of allowing governments to “own”, and take responsibility for, their policies—a mistake which supplicant governments, anxious to deny responsibility, have usually been keen to encourage. But the Fund and the Bank are aware of this criticism, and are trying to do something about it.

Other improvements in the way the international financial institutions work are surely called for. Many different panels of experts have produced countless proposals, big and small, and some of these are being taken up. Overall, a shift of emphasis is needed. Now that many developing countries have access, for good or ill, to the global capital markets, the Bank needs to focus on disseminating knowledge rather than money. And for both political and economic reasons it would be better if the Fund, for its part, specialised in providing liquidity during emergencies, rather than development finance, subject to simple financial conditions rather than immensely detailed policy blueprints.

The institutions themselves have gone far to acknowledge their mistakes, and the need for reform. In view of this, the ability of the sceptics to maintain their hysterical animosity toward the institutions is surprising. In its way, it demands a measure of respect.

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Who elected the WTO?

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The WTO is no would-be tyrant. It is democratic to a fault, and has few powers of its own

UNSURPRISINGLY, sceptics extend many of the criticisms they make of the IMF and the World Bank to the World Trade Organisation as well. If anything, they detest the WTO even more. Perhaps this is because, unlike the Fund and the Bank, the WTO brings what many critics regard as the most objectionable aspects of globalisation home to the rich countries, where most of those critics live.

The IMF undermines democracy in the developing world, the charge goes, which is bad enough; the WTO does the same thing in America and Europe as well, which is worse. The IMF and the Bank bring financial ruin to the poor countries that turn to them for help; but in the long term, the WTO inflicts even worse damage than that on all countries, rich and poor alike, solvent or otherwise. It does this, sceptics say, not through onerous borrowing conditions but by force of international law. Its prohibitions undermine efforts to protect the environment and eviscerate safeguards developed over decades to protect the health and well-being of consumers and workers.

On top of all this, of course, the specific mandate of the WTO is to promote trade, which many sceptics regard as a bad thing in itself. According to the anti-globalists' world view, it is only logical that much of the threat posed by the WTO to democracy springs from its dedication to trade. As noted earlier, many sceptics regard a liberal regime of international trade and investment as intrinsically hostile to democracy, because it promotes a competition for profits that overrides voters' political preferences.

This is the “race to the bottom” argument once more. The counter-arguments to this mistaken idea so far as it applies to taxes and the welfare state have already been rehearsed earlier in this survey. In the regulation of products and processes, with respect either to safety or to environmental impact, signs of a race to the bottom are equally hard to find. All the movement is the other way. Everywhere, the adoption of more demanding environmental standards gathers pace as incomes rise.

But sceptics are also making a separate point that is less easy to dismiss. They say that the WTO is anti-democratic not merely indirectly, because of its devotion to trade, but also directly, as a matter of institutional design. This anti-democratic character, it is alleged, is a deliberate part of the organisation's working methods—and that is unacceptable, full stop.

According to sceptics, the WTO takes powers away from elected governments and grants them to faceless bureaucrats. It can tell America and Europe that rules to protect endangered species or to keep food free of dangerous chemicals are illegal, and that they must abandon these policies. It can stop governments in poor countries providing cheap generic medicines to their people because that would hurt the profits of the drug companies. The sick must pay over the odds for patent-protected branded drugs, or do without—either is fine with the WTO.

In all these cases, sceptics say, the interests of multinational corporations happen to be in conflict with the democratically expressed wishes of the people. Whenever that occurs, the WTO rules against democracy. Moreover, the critics continue, its unaccountable and unrepresentative bureaucrats arrive at their outrageous edicts in secret: the hidden masters of globalisation are not even required to explain themselves. The WTO is a kind of embryonic world government, but with none of the checks and balances that true democratic government requires. In short, it is an embryonic world tyranny. That is why, in the view of many sceptics, it is the most dangerous of all the institutions of globalisation.

True in part

As before, this indictment combines error, gross exaggeration and apparently deliberate distortion—but, as before, it also contains particles of truth.

Is the WTO anti-democratic by virtue of its institutional design?

The WTO's anti-democratic powers are held to reside mainly in the organisation's new dispute-resolution procedures. The strengthening of these arrangements was one of the notable achievements of the Uruguay Round of trade talks which concluded in 1994; they constitute one of the main differences between the WTO and its predecessor, the General Agreement on Tariffs and Trade (GATT). Under the new rules, governments cannot block the findings of a WTO dispute panel: once they have exhausted their right of appeal, countries held to have broken WTO rules must either change their policies so as to comply, or pay compensation to the injured party, or face trade sanctions. This apparent ability to overrule governments lies at the centre of the sceptics' objections to the new system.

It is true that the system is no longer, if it ever was, a mere bundle of agreements with a procedure for arbitration should disputes arise. Even before the new arrangements were adopted, the GATT had developed a partly rule-making, as opposed to strictly rule-clarifying, character: the reforms pushed a bit further in that direction. Even so, it remains highly misleading to talk of the WTO“taking powers” or forcing governments to ignore voters' wishes.

Despite its developing quasi-judicial role, the WTO remains an unambiguously intergovernmental, rather than supragovernmental, entity. Changes to the organisation's rules are proposed by member governments and adopted “by consensus”—which in practice means they require unanimity. As the WTO likes to say, far from being anti-democratic, it is actually hyper-democratic. No government ever had to accept a new WTO rule because it was outvoted, as might happen in the European Union; every one of the organisation's 142 members has a veto.

If the WTO involves any pooling of sovereignty, therefore, it is only in an extremely limited sense. When a dispute arises, the quarrel may be over exactly what a rule means, or how it should be applied in particular, possibly unforeseen, circumstances; a government can never be compelled to obey a rule that it opposed in the first place. This applies to the new dispute-settlement rules as much as to anything else: every member government has agreed to them as well.

Moreover, the idea that the WTO enforces obedience by punishing violators is itself a distortion. Its principal role, once a dispute is under way, is still to act as referee while two or more governments fight it out. Consider a favourite example of European sceptics: the continuing dispute between the European Union and the United States over hormone-treated beef.

Europe first banned imports of such beef from America in 1989, citing health concerns. The United States has taken the matter to the WTO's dispute-settlement body. Although sceptics often claim otherwise, the WTO's rules (which, to repeat, both Europe and the United States have freely agreed to) do allow countries to ban imports to protect consumers from dangerous products. But they also require governments to show reputable scientific evidence in support of their controls, and insist that measures do not discriminate between suppliers, rather than favouring one country's exports over another's, or domestic production over imports. Without these provisos, countries could ban imports at will, something which the signatories to the agreement presumably considered undesirable.

At present, to the sceptics' horror, Europe is deemed to have violated the rules. This is not because health concerns are routinely set at naught by the WTO, as is often falsely claimed, nor even because the beef-import ban itself has been ruled illegal: the issue never got that far. It is because the EU elected to produce scientific evidence in support of its ban and then failed to do so. In due course, the WTO may authorise the United States to impose retaliatory trade sanctions of its own. In the face of that threat,

the European Union may or may not give way and lift its ban.

In either case, to say that the WTO is trying to force Europe to open its markets seems odd. It is the United States, surely, which is doing the forcing. Every case that comes before the WTO is first and foremost a dispute between governments, not a dispute between a government and the organisation itself. Also, whatever the merits of the beef-and-hormones case, America's government claims to be serving its citizens' interests, just as the EU's authorities claim to represent the voters of Europe. So it is hardly a matter of the WTO against democracy, as sceptics would have it; rather, it is a question of one democracy against a union of other democracies—with the WTO in the middle, taking the brickbats for trying to calm things down.

What if the WTO did not exist, as most sceptics seem to wish? Would the EU ban have been sustained without objection, assuring the primacy of health and environmental standards worldwide, and everywhere peace and light? Plainly not. The same trade dispute would simply have been prosecuted through other means: instead of a mediated dispute conducted under agreed rules, there would have been a naked trial of strength between the EU and the United States.

In such a contest, who knows whether Europe's view on beef and hormones would prevail? To make peace in due course, it might have to abandon its present position. What is certain is that the costs of conducting the dispute this way, rather than through the WTO's procedures, would be very much greater. And although the EU might be able to stand up for its interests in an economic fight with America, a small country in a dispute with a much bigger one would have a less good chance. That is why the governments of poor countries have been so eager in recent years to join first the GATT and then the WTO. They understand that in trade policy, unless attitudes change a lot, the alternative to the WTO is not “democracy prevails” but “might is right”.

Doing good by stealth?

As in other areas, the sceptics' overall case against the WTO is deluded—but some of their points, lost in the fog of rage, are fair. In trade policy, their strongest argument is about the system's culture of secrecy. They are right about much of this. The reasons go deeper than they may know, or governments may care to acknowledge.

The mercantilist view, that exports are good and imports are bad, is an economic fallacy

The multilateral approach to trade liberalisation, pursued first through the GATT and now through the WTO, does have a horrible flaw. It espouses the idea that lowering trade barriers is a concession you make to your trading partners; a sacrifice for which you require compensation, or “reciprocity”, in the jargon. This mercantilist view of trade—exports are good, imports are bad—is an economic fallacy. Politically—and this is to endorse a point made by sceptics—it serves to enthrone producer interests, neglecting all others. Trade agreements go forward when exporters on all sides tell their governments that they see something in it for them; the interests of importers (that is, workers and consumers at large) are implicitly regarded as politically insignificant.

This has a further consequence. Most governments insist that the grubby details of trade negotiations be kept secret; this is their idea, not the WTO's. At the end of any round of trade talks, a triumphant breakthrough backed by all sides can be announced. In the meantime, as you might expect, governments prefer to keep their negotiators' craven submission to corporate interests under wraps.

The justification for this pact with the devil is that by setting one country's producer interests against another's, it has mobilised big business in support of freer trade, helping to neutralise protectionist sentiment; as a result, trade has in fact been liberalised. Exporters have been pleased with the outcome, to be sure, but that is not the point. Liberal trade is good because it raises the incomes of consumers and workers at large, and especially because it improves the prospects of the poorest countries. It could be argued that this great prize has been well worth the cost in intellectual dishonesty and political stealth.

But whether or not the mercantilist pact can be justified in that way, its terms will probably have to change. Wrong as they are about most things, the sceptics may be right about that. Governments have no persuasive reply to the demand that trade policy should be conducted in public, and that the WTO's dispute-settlement machinery, especially, should work in plain sight. Proponents of liberal trade can no longer expect trade policy to be sheltered, in the interests of “effectiveness”, from the demands for honest, open and accountable governance that are regarded as compelling in other areas.

If the mercantilist pact breaks down under public scrutiny, as it may, there is a risk that the cause of liberal trade will be set back. Certainly that is what anti-globalists are hoping. But there is also another, more encouraging, possibility. If governments still want to promote liberal trade—and rising incomes, other things equal, are popular with voters—they could try to do so on its economic merits. Being honest would be inconvenient, and after all these years would certainly seem peculiar. Exporters would be displeased to find that governments were listening to them less avidly. But governments would find it easier to be straightforward about the case for trade. Perhaps they could even convince themselves, and enough voters to make the difference, that unilateral, uncompensated trade liberalisation is the best way to serve the public interest.

If they could do that—but only then—the WTO in its present form would no longer be needed at all, and liberals could join sceptics in celebrating its demise. But given the demands this would place on government, that day will not dawn just yet.

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A different manifesto

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If sceptics could learn to love capitalism, they would still have plenty to complain about

SOME sceptics have recently started to argue that the movement against globalisation dwells too much on what it is against; it must grow up, and start to say what it is for. This is a worthy thought, but tactically ill-advised.

The main things holding the anti-globalist coalition together are a suspicion of markets, a strongly collectivist instinct and a belief in protest as a form of moral uplift. Once upon a time this combination would have pointed to socialism as a coherent alternative to “the system”. But socialism, after the unfortunate experiences of the 20th century, is not quite ready yet for release back into the community. The attitudes that support it are still out there, as evidenced by the protesters, and by the sympathy they arouse among the public. But for the moment, as a programme for government, socialism lacks sufficiently broad appeal.

What else is there? The protest coalition can hang together only if it continues to avoid thinking about what it might be in favour of—a challenge it is all geared up to meet. All the same, it seems a pity.

Meanwhile, the champions of globalisation—governments and big business—are also giving a deeply unimpressive account of themselves. Intellectually, their defence of globalisation (“it's good for our exporters and creates jobs”) is a disgrace. And governments deserve fierce criticism for many of their policies, not least in areas of particular concern to anti-globalists.

Rich countries' trade rules, especially in farming and textiles, still discriminate powerfully against poor countries. Rich countries' subsidies encourage wasteful use of energy and natural resources, and harm the environment. It is at least arguable that rich countries' protection of intellectual property discriminates unfairly against the developing world. And without a doubt, rich countries' approach to financial regulation offers implicit subsidies to their banks and encourages reckless lending; it results, time and again, in financial crises in rich and poor countries alike.

All these policies owe much to the fact that corporate interests exercise undue influence over government policy. Sceptics are right to deplore this. But undue influence is hardly new in democratic politics; it has not been created by globalisation forcing governments to bow down. On the contrary, special-interest politics is easier to conduct in closed economies than in open ones. If allowed to, all governments are happy to seek political advantage by granting preferences.

It is dispiriting to watch as big companies work out how to maintain their influence nationally and extend it to the global arena, using “civil society” and “corporate social responsibility” as levers. Naturally, in the light of the protesters' concerns, the multinationals are willing to sit down with governments and NGOs—they have lots of ideas for collecting extra subsidies, and piling punitive taxes and regulation on their less responsible competitors.

Barking up the wrong tree

The protesters' main intellectual problem is that their aversion to capitalism—that is, to economic freedom—denies them the best and maybe the only way to attack and contain concentrations of economic and political power. The protesters do not need to embrace laisser-faire capitalism. They need only to discard their false or wildly exaggerated fears about the mixed economy; that is, about capitalism as it exists in the West, with safety-nets, public services and moderate redistribution bolted on.

Under this form of capitalism, economic growth does not hurt the poor, as sceptics allege; indeed, for developing countries, capitalist growth is indispensable if people are ever to be raised out of poverty. Growth in mixed economies is compatible with protecting the environment: rich countries are cleaner than poor ones. And if prices are made to reflect the costs of pollution, or allowed to reflect the scarcity of natural resources, growth and good stewardship go hand in hand. Above all, free trade does not put poor countries at a disadvantage: it helps them.

Try this for size

If some of the protesters could accept these tenets of mixed-economy capitalism, a narrower but far more productive protest manifesto would come into view. Its overriding priority would be to address the scandal of third-world poverty. To that end, it would demand that rich-country governments open their markets to all developing-country exports, especially to farm goods and textiles. (Concerns about displaced workers would be met not by holding down the poorest countries, but by spending more on training and education in rich countries, and by cushioning any losses in income there.) It would insist that western governments increase spending on foreign aid, taking care that the benefits flow not to rich-country banks or poor-country bureaucrats, but to the poor, and especially to the victims of disease. To protect the environment, it would call for an end to all subsidies that promote the wasteful use of natural resources, and for the introduction of pollution taxes, including a carbon tax, so that the price of energy reflects the risk of global warming.

This programme to accelerate globalisation and extend the reach of market forces—although at first it might be better to put it another way—would also have a good-governance component. Under that rubric, “trade policy” should ideally be abolished outright: governments have no business infringing people's liberty to buy goods where they will, least of all when the aim is to add to corporate earnings. Short of instant abolition, trade policy should at least be brought into the light so that corporate interests find it harder to dictate its terms. Governments should hold themselves accountable to voters at large, not to companies, industry associations, special interests or indeed to any kind of non-governmental organisation, whatever its ideology or dress code.

Governments should hold themselves accountable to voters, not special interests

Among other things, accountability means accepting rather than denying responsibility. Corrupt or incompetent governments in the developing countries deny responsibility when they blame the IMF or the World Bank for troubles chiefly caused by their own policies. Rich-country governments, notably America's, also use the Fund, the Bank and the WTO—institutions which in practice could never defy their wishes—to deflect blame. Worst of all, governments everywhere deny responsibility when they explain broken promises, failures of will or capitulations to special interests as the unavoidable consequences of globalisation. That is no harmless evasion, but a lie that rots democracy itself. Critics of economic integration should be striving to expose this lie; instead, they greet it as a grudging endorsement of their own position.

The crucial point is that international economic integration widens choices—including choices in social provision—because it makes resources go further. Policies to relieve poverty, to protect workers displaced by technology, and to support education and public health are all more affordable with globalisation than without (though not even globalisation can relieve governments of the need to collect taxes to pay for those good things). When governments claim that globalisation ties their hands, because politically it makes their lives easier, they are conning voters and undermining support for economic freedom. Whatever else that may be, it is not good governance.

Whenever governments use globalisation to deny responsibility, democracy suffers another blow and prospects for growth in the developing countries are set back a little further. Anti-globalists fall for it every time, seeing the denials as proof of their case. They make plenty of other mistakes, but none so stupid as that.

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Sources and further reading

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This survey has drawn on the work of many authors. The parts of the survey that deal with multinationals in the developing countries owe a particular debt to "Fighting the Wrong Enemy: Anti-Global Activists and Multinational Enterprises" by Edward Graham, published by the Institute for International Economics.

Representative selections from the anti-globalist canon include: "No Logo" by Naomi Klein, Picador, 2000; "Whose Trade Organisation?" by Lori Wallach and Michelle Sforza, Public Citizen, 1999; "The Captive State" by George Monbiot, Macmillan, 2000; "Everthing for Sale" by Robert Kuttner, Knopf, 1997; "Dark Victory" by Walden Bello and others, Food First Books, 1999; and "The Silent Takeover" by Noreena Hertz, Heinemann, 2001. A more persuasive sceptic (or quasi-sceptic) than any of these is Dani Rodrik: see "Has Globalisation Gone Too Far?" Institute for International Economics (IIE), 1997; "The New Global Economy and Developing Countries: Making Openness Work", Overseas Development Council, 1999; and "Governance of Economic Globalisation", an essay in "Governance in a Globalising World", edited by Joseph Nye and John Donahue, Brookings, 2000. (This volume contains many other interesting papers.) Joseph Stiglitz's memorably intemperate attack on the IMF and the World Bank appeared in *New Republic*, issue of April 17th 2000.

"The Lexus and the Olive Tree" by Thomas Friedman, Farrar Straus and Giroux, 2000, is a best-selling, much-quoted and deeply unsatisfactory sort-of defence of globalisation. Much the most effective rebuttal of the charges levelled by anti-globalists against multinationals is "Fighting the Wrong Enemy" by Edward Graham, IIE, 2000. See also two pamphlets by David Henderson: "The MAI Affair: A Story and Its Lessons", Royal Institute of International Affairs, 1999, and "Anti-Liberalism 2000", Institute of Economic Affairs, 2000. The website of the Institute for International Economics contains a section devoted to briefing papers and other materials on globalisation: warmly recommended.

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Travel industry

A business in search of customers

Sep 27th 2001 | FRANKFURT, LONDON, NEW YORK, PARIS, SAN FRANCISCO AND TOKYO
From The Economist print edition

From airlines and cruise lines to hotels and festival organisers, travel companies continue to suffer in the aftermath of the attacks on America

Get article background

Reuters

Lining up for passengers

THE reeling from the after-shocks of the disaster on September 11th is far from over. As airlines struggle to repair schedules and to fill empty aircraft, hotels are contemplating vacant rooms and silent bars. In New York, Boston, San Francisco and even Las Vegas, occupancy has fallen by around 40%. But the effects are being felt round the world. From the Georges V and the Meurice in Paris, from the Savoy and Claridges in London, and from the Imperial and Okura in Tokyo, the message is the same: the Americans are gone, leaving hotels half-empty. Some of the more luxurious rely on American tourists and executives for as much as half their business.

The ripples spread even wider. In Paris, for instance, the *grands magasins* of Boulevard Haussmann and the posh boutiques of the Rue du Faubourg St-Honoré also rely on Americans for around half their sales. Some 2m Americans visit Paris each year, helping tourism to support 15% of the city's jobs. In Britain, the effects are being felt along the familiar tourist routes travelled by foreigners from London to Bath, Stratford, York and Edinburgh—with visitor numbers expected to fall 25% below normal for the rest of the year. Meanwhile, attendances for the first days of Munich's Oktoberfest were 30% down on last year.

Different effects are being felt elsewhere as other tourists cut their travel too. A quarter of the package tours booked to Hawaii, Guam and mainland America by one leading Japanese travel agency have been cancelled. Australia's tourist industry, approaching its peak season, reports foreign bookings down 25%. Back in America an already troubled Pacific cruise line has suspended operations and one online travel agency has closed down for lack of business; a number of its rivals are on the brink.

Things will get worse before they get better

Things will get worse before they get better. The World Travel and Tourism Council, a trade body, talked this week of a 30% drop in global travel-industry revenues, before swiftly (and inexplicably) switching to a much less pessimistic forecast: a fall over the next 12 months of 10-20% in America, and less in Europe and Asia. IATA, which represents big airlines, forecasts that international air travel for the second half of this year could be down by 16%, while domestic American traffic could fall by 17.5%. But even IATA'S economics director, Peter Morris, admits that these are mere guesses.

Airlines are in every sense in the front line, and they have announced more than 100,000 job losses in America and Europe as they shrink. In America, the industry was quick to calculate the immediate cost of the emergency shut-down and depressed travel thereafter, not least because it wanted to present a convincing case for the $15 billion of federal aid it received last week. According to Leo Mullin, chief executive of Delta Air Lines, which this week cut 13,000 jobs, by the end of September airlines in America will have lost $4.7 billion as a result of the terrorist attacks. The Air Transport Association (ATA), which represents American airlines, hopes that traffic will recover to 60% of normal levels (ie, aircraft at least three-quarters full) by the end of the year, and to 85% of normal levels by next June.

While Air Canada this week followed the American carriers and cut 20% of capacity, the European

response has been more muted, with average cuts of around 10%. Alitalia has gone further: this week the Italian carrier cut 4,000 jobs, about 17% of its total workforce, and was lining up state aid worth as much as $190m, despite the European Union's ban on subsidies. Swissair, which was already in dire trouble before the attack, has announced 3,000 lay-offs at its catering subsidiary—mainly in America—and has unveiled plans to turn itself into a low-cost carrier, based on its regional affiliate, Crossair. And British Airways plans to prune its European network drastically.

Europe's low-cost carriers, which don't operate transatlantic routes, are faring better. As in America, where low-cost Southwest Airlines announced special cheap fares this week, the no-frills Europeans—led by Ryanair and easyJet—have slashed prices in response to a 25% fall in bookings after the attack.

Hostile reception

The world's hotels are only ever a short taxi ride away from any recession in air travel. This crunch has hit at what should be their busiest time of year. September is normally a big month for business conventions (see article), and October is the peak month for hotels in business cities. But occupancy in America plunged as low as 30% on September 16th for the Sheraton, Westin and Four Points hotels in the Starwood empire. For September as a whole, 83% of Starwood's bookings were cancelled. The group has cut its staff by 23%.

For hotels, the crunch has hit at the busiest time of year

Other hotel groups are more optimistic. Marc Grossman of Hilton Hotels, which owns or manages 2,000 hotels in America, says the group is assuming that business will pick up after a couple of months, to reach the levels of the late 1990s. But Roger Cline of Andersen, a consultancy active in the travel business, thinks the crisis will prove “pretty devastating”. He notes that room revenues were already falling in the first half of this year. Now he thinks that this year will be the worst since the Gulf war in 1991. Then, the hotel chains were financially weak even before the slump. This time, they are buoyed by nine boom years and helped by low financing costs, which means their break-even levels are on the whole much lower.

Buttressed by this relative financial strength, the hotels have more room for manoeuvre now. They are already reportedly offering discounts of up to 50% in big American cities. Just as, in the 1990s, airlines became adept at filling aircraft profitably by using dynamic “yield-management programmes” to move prices in line with demand, so hotels are now resorting to similar techniques instead of sticking to fixed room rates. Their expertise in this game will be severely tested over the next six months.

Underlying both the optimists' hopes and the pessimists' darkest anxieties about their business future is a working assumption that there will be no more hijackings or similar terrorist acts in America. Still, nobody is taking any chances. In San Francisco, for instance, the pedestrian walkways on the Golden Gate Bridge were closed to protect yet another iconic American structure. There are fears that one of the procession of loaded tankers heading for Oakland's oil terminals might be hijacked and used to blow up the bridge. For the next few months the travel industry, like the rest of the world, will have to hold its breath.

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America's car industry

Every trick in the book

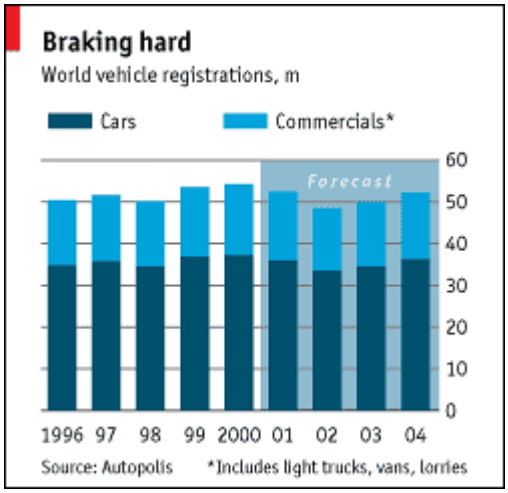
Sep 27th 2001 | PONTIAC, MICHIGAN
From The Economist print edition

Going to great lengths to re-ignite sales

IT IS quiet enough on the floor of Joe Lunghamer Chevrolet to hear the rain pattering against the showroom's huge plate-glass windows. Salespeople linger, read newspapers or find little tasks to keep busy. The past two months have seen a steady decline in the number of customers walking into the suburban Detroit dealership. In the wake of the September 11th terrorist assault, that trickle has all but run dry. “The only people we're seeing right now are buying out of necessity,” laments Mr Lunghamer, who opened the store 35 years ago. Everybody else, he fears, will wait to see which way events—and the American economy—go in the coming weeks. And the omens are bad: consumer confidence has just taken its steepest dive in a decade.

This year may yet go down as the third-best in American automotive history, but right now the market is in meltdown. John Casesa, an analyst with Merrill Lynch, predicts that sales in September will be down 15% on last year. Adjusting the numbers for seasonal fluctuations would yield an annualised rate of 14.8m car and truck sales, down from 17.4m a year ago. With dealers across the country in the same situation as Lunghamer Chevrolet, factory orders are fast drying up. And the car industry is taking a close look at its production plans.

The situation became much worse when the Bush administration clamped down on border crossings. Suddenly, Canadian and Mexican suppliers found themselves waiting many hours to get parts to American assembly lines. With little or no inventory, General Motors, DaimlerChrysler and Toyota found themselves sending workers home early. Hardest hit was Ford, which has lost production of up to 120,000 vehicles in September.



Easing the delays was a central topic at an unprecedented meeting between industry, labour and government leaders held at the Cadillac assembly plant in Detroit on September 19th. Unlike the airline industry, the Big Three American car makers did not ask for federal hand-outs, but they made clear that things could go from bad to horrible in a hurry.

The message was not lost on Don Evans, the commerce secretary, who declared that the car industry was “a backbone of the American economy”—car makers account for more than 5% of America's GDP and, directly or indirectly, one in seven of its jobs. With consumers fast losing their nerve and recession imminent, the car companies could set off a vicious circle of plant closures and lay-offs, triggering further falls in consumer confidence and still more plant closures.

While no corporate bosses would pledge to keep plants running, Dieter Zetsche, chief executive of DaimlerChrysler's loss-making Chrysler Group, stressed that “we clearly don't intend to overreact.” But ultimately, the bosses argued, they would have to bow to market forces. “To drive production into the face of low consumer demand at some point catches up with you,” noted Ford's chairman, William Clay Ford Jr.

Lack of interest

Still, the summit was awash in patriotic fervour, and a sense that the industry has to play its part in America's new war footing. Within hours, General Motors had announced an interest-free customer-

finance programme for most of its new products. Ford and Chrysler quickly fired off similar salvoes of their own.

Some dealers report that these campaigns have generated a bit more showroom traffic. But they have not been well received on Wall Street. The cost will be steep, reckons Nick Lobaccaro, chief automotive analyst at Lehman Brothers in New York. GM alone is spending an estimated $3,000 per vehicle on various incentives, which may prop up sales, but at the expense of profitability. And although the new loan programmes are due to expire at the end of October, Mr Lobaccaro points out that curtailing such giveaways has proved hard in the past.

The “Buy America” campaign isn't selling

Aggravating the industry's woes until recently has been the strong dollar, which has helped Asian and European car makers, whose sales have been falling more gently than those of their American rivals. In August, Toyota came within 6,000 units of overtaking Chrysler, the number three player behind GM and Ford, in the American market. If the Japanese firm can keep up its momentum, this will be the first time that one of the Big Three has been overtaken by a foreign brand. Toyota has not been shy about using profits from a competitive exchange rate to finance its drive for a bigger market share.

With patriotism in the air, some Big Three executives have tried to revive the old “Buy American” campaign. But this is not resonating with consumers, and for good reason: it has become harder than ever to define an “American” car. Foreign car companies continue to expand their North American production base. Nissan is building a giant new pick-up plant in Mississippi. In nearby Alabama, Mercedes-Benz has announced a $600m expansion of its M-Class sport-utility line.

As if falling sales, profits and market share were not enough, the Big Three were handed bad news about their debts this week when Standard & Poor's, a credit-rating agency, put all three on credit watch. A decision to downgrade their debt would tighten the financial vice, as the car makers drain whatever cash they have left in their so-called “rainy day” funds.

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The conference business

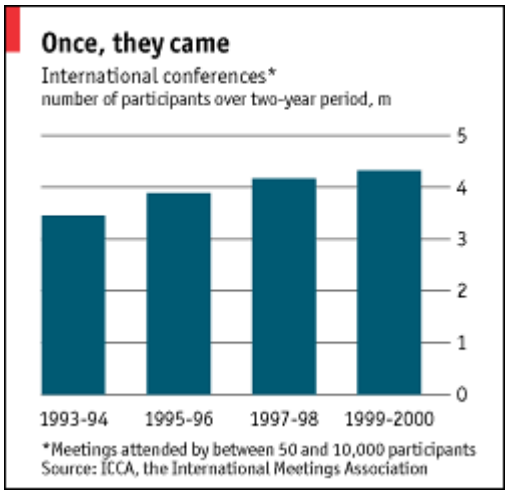
Shall we meet again?

Sep 27th 2001
From The Economist print edition

Fears of further attacks threaten business conferences and conventions

WILL terrorists succeed where the communications revolution failed? The end of business conferences has often been predicted. It has never felt closer than now. Since the attacks on September 11th, at least 60 international conferences have been cancelled. They range from the annual meetings of the World Bank and the International Monetary Fund, in Washington, to the Society of American Foresters National Convention, in Denver. And although America has been worst hit, high-profile conferences in France, Japan and Britain have also been abandoned.

Once, the conference business seemed threatened by telephony, video-conferencing and the Internet, which were all supposed to make face-to-face meetings redundant. In fact, the opposite happened in the 1990s (see chart). Last year, conferences generated estimated revenues of $120 billion in America alone. Visiting public events is no longer the privilege only of those at the top of the organisation: in the United States, the right to attend a certain number of conferences and training programmes every year is now often written into middle managers' contracts.



However, the terrorist attacks came at a critical time for conference organisers. Participants were already becoming more selective, especially on the technology-conference circuit. Events with a special character—such as the Swiss ISC Symposium in May, the first management conference organised by students—had seen only a slight fall-off in interest, but less distinctive get-togethers had suffered badly. Another threat has come from the anti-globalisation brigade. Even when violence was avoided, the costs to host cities of providing adequate security had become huge. The IMF had already shortened its meeting to two days, from seven, before cancelling.

Hotels and convention centres will also suffer from the industry's woes. Attracted by the boom of the past few years, organisers in established destinations, such as London and New Orleans, have greatly expanded their facilities. Others, such as Johannesburg and Weimar, have tried to put themselves on the map by building fancy new halls, creating a glut in meeting space. At least this overcapacity should reduce the cost of renting facilities; together with cheaper air fares, this could help to attract visitors even in a recession. Any takers for a conference on “Business Strategy After the Day the World Changed”?

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The prospects for oil

Clear as mud

Sep 27th 2001
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Oil prices are falling—for now

“NO REASON to panic,” cooed Bijan Zanganeh, Iran's oil minister, this week in an effort to calm oil markets before a meeting of the OPEC cartel in Vienna on September 26th. “We believe OPEC is able to manage the market and this situation is mainly because of speculation and will disappear very soon.”

For much of the past two years, the cartel's bosses have periodically offered such platitudes, as prices edged up past $30 a barrel. Their aim used to be to reassure the big consuming economies that they would not let prices go too high for too long. This time, though, Mr Zanganeh's plea could well have been directed at fellow cartel members—for oil prices are now heading in the opposite direction.

After the American terrorist attack, prices shot up briefly on fears of reprisals. But punters now seem to have decided that the bigger threat comes from the spectre of global recession—and the impact that will have on oil demand. Such worries pushed oil prices down sharply this week—by almost $4 a barrel on September 24th alone—and market-watchers say they could yet fall further. The price of a basket of OPEC crudes, which the cartel has been trying to keep in a range of $22-28 a barrel, even dipped briefly below $20.

What can OPEC ministers do about this? They could have agreed this week to cut production to push prices up: that, after all, is the *raison d'être* of cartels. In the event, they did no such thing. The United States, which has troops stationed in oil-producing Saudi Arabia and Kuwait, made it clear that it would frown on a concerted effort to lift prices. So OPEC agreed to leave its production target at 23.2m barrels a day.

That should not be taken at face value, however. OPEC could not be seen to be taking action this week, but members will try to reduce the supply of oil quietly, by cutting down their cheating. Most are actually producing above agreed levels; some analysts reckon that Saudi Arabia may be producing 1m barrels a day or more above its quota of 7.5m.

What is more, ministers plan to meet again in November to reassess the situation. There is already talk that they may agree cuts by telephone next month. They are clearly nervous. After two years in which the cabal has been dictating prices, OPEC now looks to be at the mercy of a force that may be more volatile and fickle even than its cartel: the market.

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Mergers delayed

Wait and see

Sep 27th 2001
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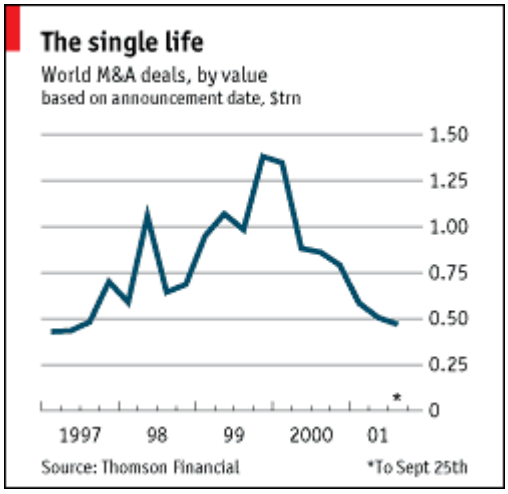
Collapsing markets and uncertainty are discouraging deal-making

FOR investment bankers, life was already glum before the horror of September 11th. Since then, it has grown even bleaker, with the cancellation or postponement of several mergers and acquisitions. In the two weeks after the attack, 20 companies cancelled $15 billion-worth of mergers, according to Bloomberg, a financial-news company.

Among them was one between FelCor Lodging and MeriStar Hospitality, two American property businesses specialising in hotels. The companies specifically blamed “recent tragic events” for their decision. Vinci, a big French airport-construction specialist, made no such reference when it allowed its offer for TBI, a British regional-airport operator, to lapse on September 24th—but the company must be glad to be off the hook. Havas Advertising, a French media group, referred to the uncertainty of the times when it allowed its recommended offer for Tempus, a British agency, to lapse. And Telefonica Moviles, a Spanish mobile-phone operator, also blamed the attacks when it cancelled an offer to buy Brazil's Celular CRT.

Some of these companies may be using the attacks as a convenient excuse for a decision that would have been taken anyway. The jolt to corporate confidence comes on top of a plunge in share prices that makes it harder to value companies. “Lots of deals are in a holding pattern,” says Henry Gibbon, editor of *Acquisitions Monthly*, a magazine.



Many were already floundering a fortnight ago. General Motors' planned sale of its Hughes DirecTV business to Rupert Murdoch, who yearns to break into satellite television in America, had run into problems long before September 11th, partly because of a sharp fall in the value of Hughes's shares. They have dropped by over a third since late August, mainly because of fears of a sharp decline in the American advertising market. GM badly needs cash to protect itself from the downturn in the American car market. Difficulties have also beset AT&T's attempts to sell its cable-television business after it rejected a $58 billion offer from Comcast in July. Comcast's shares have also dropped sharply, cutting the value of its offer.

In the past, companies might have wriggled out of unwanted mergers by using the “material adverse change” clause that many deals contain. Such clauses have become less common recently. But when Schroder Ventures and Goldman Sachs Capital, two private-equity firms, agreed on September 12th to buy Cognis, the specialty-chemical arm of Henkel, a German company, they insisted on the right to pull out within two months if financial markets deteriorated further. Such buyouts depend on stable stockmarkets to resell the businesses that have been acquired and restructured.

For companies with footloose staff, the failure of a merger that is made public “can be very bad news: all your staff walk out the door,” says David Rhodes, who runs the financial-services practice at the Boston Consulting Group in London. An abandoned acquisition usually puts the target company into play.

Not all deals are being dumped. Since September 11th, RWE, a German power company, has agreed to buy American Water Works for $7.6 billion. VeriSign, a leading Internet company, said on September 24th that it would acquire Illuminet Holdings, another communications business, for $1.2 billion in shares. Even the purchase of Compaq by Hewlett-Packard, mocked when it was first announced, may

now go through, if only because a recession could increase the attraction of size. Certainly, terrorism has not stopped the bosses of HP and Compaq from keeping to a packed schedule of meetings.

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Television news

Screen test

Sep 27th 2001
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Will media groups be buoyed or damaged by covering a war?

THE attacks on America exposed both the shortcomings and the unexpected virtues of new media over old. Although many Americans were at work when the assaults took place, it was to the television set, which they could watch together, not the solitary computer screen, that almost everybody turned. Only 3% of those connected to the Internet actually used it as their chief source of news, according to one poll, but 78% used the TV. During prime time on September 11th, 69% of households watched one of the 11 broadcast or cable networks carrying non-stop news, according to Nielsen Media Research; in New York, the figure was 76%. CNN, the most popular cable network, saw its prime-time audience soar almost tenfold from the previous evening, to 7.7m.

This was not for want of trying to follow events on the Internet. Within America, there were an average of 11.7m unique visitors to news websites each day during the week, according to Jupiter MMXI, an Internet research group—almost twice as many as in the previous week. Millions more attempted to reach news sites, but failed because of overload. Some sites stripped down their picture content to make it quicker to download text. This underlined the clunkiness of the medium, which sends each viewer an individual version of content and is therefore an inefficient means of distributing text, let alone moving pictures, from a single source.

The Internet did prove its value, however, as a medium for communication between individuals. With many cellular and landline telephones out of use in the aftermath, many survivors used e-mail to contact family and friends. Some of these personal accounts were then widely circulated, providing harrowing news reports to strangers—a case of new technology providing a means of communicating in ways that preceded mass media.

Now that the news organisations are preparing for coverage of war, however, it is back to more familiar forms of reporting. Although it is considered tasteless to find solace in improved ratings, media groups plainly welcome the rise. CNN, for instance, had been much exercised before the attacks by its faltering performance at home compared with newer cable news channels, such as Fox News.

Yet the economics of non-stop news are shaky. Even before September 11th, ad spending was down: it fell by 6% in the first half of 2001 from the year before, according to CMR, a research group. Then, in the week of the attacks, CNN chose to carry no advertising for six consecutive days, and the big networks did so for four. The networks lost $350m of ad revenues that week, estimates Leland Westerfield of UBS Warburg, an investment bank.

At the same time, the costs of coverage will mount. Over the past decade, the broadcast networks have cut their overseas bureaus, as foreign news has been elbowed aside by domestic distractions and chat. Networks now need not only to support extra staff abroad but to buy in news feeds. CNN, which still has 30 overseas bureaus, has set 70 people on to the story in Central Asia and the Middle East, more than it has ever put on an international story. Already, Viacom, which owns CBS, and AOL Time Warner, which owns CNN, have put out profit warnings since September 11th, blaming in part “significant loss of revenue” and a “considerable increase in costs” during the attacks.

Yet all media groups, with or without a television-news operation, are in trouble. Compared with the effect of a sustained ad slump across all the outlets of a media conglomerate, the extra news costs should be manageable. CNN, for instance, is just a sliver of AOL Time Warner: with its sister news networks, it contributes some 4% to total revenues.

In all of this, there are opportunities as well as risks. Since September 11th, CNN has signed up big new

clients, such as France's TF1 and Germany's ZDF. As Chris Cramer, head of CNN International, puts it: “It was seductive to say that CNN arrived during the Gulf war. But we are now ten times bigger. We're doing this for the long run.”

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About sponsorship

Corporate “winners”

Silver linings

Sep 27th 2001 | NEW YORK
From The Economist print edition

Some companies have flourished in the wake of the attacks

EPA

Not flagging

NEW YORK'S umbrella hawkers, who appear as if by magic with the first drop of rain, know better than anyone that even the darkest cloud can produce profit. Since the tragedy at the World Trade Centre, they have been doing a brisk trade in miniature American flags. They are not alone in benefiting from an opportunity that nobody would have wanted—but is rightly being taken.

Demand for Old Glory is at record levels, both in New York and nationwide. The five biggest flag makers are so swamped that they have stopped answering their telephones. Some have applied for emergency permits allowing them to operate seven days a week. Their websites warn customers of delays of up to eight weeks in filling orders. The surge in demand has driven many wholesalers and retailers to look overseas. Low-cost foreign manufacturers—primarily in China, Taiwan and South Korea—sold about 5m Stars and Stripes in America last year (10% of the total). Most were miniatures, but America's domestic manufacturers fear that the current flag hysteria may let foreign competitors into the market for full-sized flags.

On the couch

The crisis in New York, the world capital of psychoanalysis, has also been a bonanza for therapists, many of whom have been signed up by affected companies to counsel grieving or traumatised employees. Unless you are referred by a client firm, or are an existing patient, you cannot find a shrink willing to see you for months.

Security firms and shrinks are in demand

Security firms are also in demand, both broad-based multinationals, such as Pinkerton and Kroll, and more specialist operators. Mike Herstik of Detectiondogs.com reports that demand for bomb sniffer-dogs has soared, and “it's not just New York. Los Angeles is going crazy too.” A man-and-dog team costs $100-250 an hour, with a typical daily minimum of $2,000. High-tech security firms are also expected to gain—from explosive-detection gadgets produced by InVision Technologies to Visionics' biometric security systems. So are videoconferencing systems and other substitutes for face-to-face meetings produced by firms such as Polycom, Picturetel and WebEx.

In a tragic twist, New York's commercial-property market also looks like another winner: it had been on the point of a slump, but has now been revived by the attacks. These destroyed or damaged 22 buildings, taking out 9% of the city's total office space. Around half of that is likely to be repaired before long, but the fate of the World Trade Centre site remains uncertain.

Displaced firms are scrambling for space, both on and off Manhattan. The spanking new lower-midtown offices of “Silicon Alley” will no longer be deserted museums to the dotcom bubble. Although landlords have magnanimously promised to keep rents at pre-disaster levels, this may apply only to displaced firms, and it still implies higher rents across the market than seemed likely before September 11th.

According to Steve Sakwa of Merrill Lynch, in the short term there will be severe scarcity in New York, which is now destined to remain one of the tightest office-space markets in the country. Companies that are likely to benefit from this include Mack-Cali and Vornado, two real-estate investment trusts with a strong presence in Manhattan.

Commercial airlines and car-rental firms are suffering, but executive-jet firms are booming. Amtrak, a train operator, has also seen a surge in passengers, particularly in the Washington-New York-Boston corridor—yet it is asking, brazenly, for more federal subsidies to cope. Such customers might even switch permanently if Amtrak can get more of its trains to run on time.

As always, war is good for makers of military hardware, and the shares of defence contractors have been soaring since the attack. At a lower level, another weapons industry is also seeing an uptick: sales of handguns are rising, as more people want to be able to defend themselves. Airline pilots are lobbying for the right to carry handguns in cockpits.

Some see Hollywood as a big loser from the attacks, not least because it has had to delay the release of several movies with storylines that were too topical for comfort. But even this dark cloud has a silver lining. A growing number of films and TV shows have been shot abroad in recent years: Canada, Australia and Britain all offer lower production costs than America. Since September 11th, however, entertainment bosses and actors have grown uneasy about the thought of spending time away from home, and the risk of being stranded. For workers in Los Angeles who depend on the entertainment industry, such as carpenters, lighting technicians, hairdressers and dry-cleaners, the prospect of film-making coming home is welcome. It is an ill wind...

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About sponsorship

Terrorist finances

Getting to them through their money

Sep 27th 2001 | LONDON AND NEW YORK
From The Economist print edition

EPA

President George Bush aims to stop Osama bin Laden, or anyone else, from financing terrorism. Easy enough to say

"TO FOLLOW the money is a trail to the terrorists," said George Bush, as he released a list of 27 alleged customers of the global banking industry that he called "the financial equivalent of law enforcement's most-wanted list". Among those whose accounts President Bush ordered frozen on September 24th were Osama bin Laden, his al-Qaeda organisation, a handful of Islamic charities and an import-export company. Yet most terrorist assets are outside America (the import-export company is based in Hamburg, Germany), and no doubt also under disguised names. So what are the chances that Mr Bush's edict will harm those he has declared war on?

Not that great, to judge by past efforts to track down dirty money, or to stop it crossing national borders. The assets of a few, high-profile individuals, such as the late Sani Abacha, once president of Nigeria, have been frozen or confiscated. Some money generated by criminal activities, notably drug trafficking, has been grabbed by the authorities. The amounts, though, are tiny in comparison with all the world's illicit money. The International Monetary Fund reckons that the amount of dirty money being washed through the financial system is huge: between $500 billion and $1.5 trillion a year—equivalent to up to 5% of gross world product.

The authorities have certainly tried. In America, laws against money laundering now consume vast resources at banks, which are required to "know your customer" well enough to be sure they are not getting their cash from criminal sources, and to report to regulators any suspicious financial transactions. The OECD'S Financial Action Task Force (FATF) has been increasingly active in seeking an international response to money laundering.

The main problem is that in many countries—most notably offshore financial centres with light regulation and low taxes—bank customers are protected by privacy and secrecy laws. Political pressure on these countries has intensified in recent years, and sanctions have been mooted (though not imposed) against countries with particularly unhelpful laws or inept enforcement. But this has had a limited impact. Banking secrecy is lucrative for those jurisdictions that practise it.

Banking secrecy is usually too lucrative to abandon under pressure

When money passes through secretive centres, it hard to see where it has come from, or where it goes.

For foreign banks with clients in such centres, knowing the customer can be all but impossible—particularly given the global network of “correspondent” banks (see article).

The methods that terrorists use to move money from regions that finance them to their target country are often identical to those used by criminal gangs. For instance, money-laundering experts say that both groups use a technique known as a “starburst”. A deposit of dirty money is made in a bank with standing instructions to wire it on in small, random fragments to hundreds of other bank accounts around the world. Tracking down the money thus becomes a war of attrition, since getting legal permission to pursue bank accounts in multiple jurisdictions can take years. The “boomerang” is another trick: money is sent on a long arc around the world, before returning to the country whence it came. En route, it travels through what money launderers refer to as “black holes”, meaning countries that lack the means or the inclination to investigate banks.

There are, however, some differences between money laundering and financing terrorism, says Patrick Moulette, head of the secretariat at the FATF. The source of terrorist money might, for a start, be legal. It might come from a wealthy individual, or a religious charity. If so, the money starts off “clean”, becoming dirty only when the terrorist crime is committed later on. That makes it far harder for banks to spot. As well as scrutinising the origins of the money they accept from new customers, banks need to make subjective judgments about the money's likely uses.

Mr bin Laden's organisation is a prime example of a trend in the financing of terrorism over the past decade. As state support for terrorism has waned, so more has come from individuals. Some donate large sums, but a lot of funding is believed to come from Islamic charities in the Middle East, Europe and America.

As state support for terrorism has waned, so more has come from individuals

Targeting charities is itself fraught with difficulty. This week Britain's Charity Commission took the International Islamic Relief Organisation, reported to be a backer of the al-Qaeda network, off its list of registered charities, saying that it shows no sign of functioning as a charity. But another investigation into Interpal, or the Palestinian Relief & Development Fund, also accused of terrorist links, was abandoned in 1996 after the commission could find no evidence of a connection. The poor in Muslim countries will be the victims of any indiscriminate crackdown on charities. In any case, say anti-terrorism experts, charities are likely now to be regarded as an old, unsafe mechanism by Mr bin Laden's network.

For ill-gotten money, the challenges are every bit as great for the authorities. Winning the legal right to look into a bank for stolen money can take months, complains Martin Kenney, who founded Interclaim, a Dublin-based business which tracks down lost assets for companies and individuals. Because of laws to protect people's privacy, investigators may go to a bank only once they have a well-developed case.

The pressure to change bank-secrecy laws will now grow. Fresh ways to crack down on terrorist funding will also be needed. One, says Mark Pieth, professor of criminal law at the University of Basel, would be to take aim at what he calls “tax optimisation experts”. These people, who know how to construct shell companies and other structures to hide wealth, also introduce their clients as new customers for banks. They know far more than do bank officials about any new customer's potential links with terrorism or organised crime.

Despite the obstacles, the American Treasury's new Foreign Terrorist Asset Tracking Centre, and other bodies, will probably find some of the hoard of Mr bin Laden and others on Mr Bush's list. It seems that banking details of the hijackers of the planes used in the suicide attacks, and of other arrested associates, furnish the beginnings of an electronic trail that leads to accounts in secretive countries.

Some of Osama bin Laden's hoard will likely be found

International co-operation is the key. Even so, Mr bin Laden's money will be salted far and wide. Moreover, there is no traceable trail to follow in the kind of traditional, trust-based banking known as *hawala* that Mr bin Laden may have used extensively. Here, Muslim bankers in different places make payments on the promise that a corresponding payment has taken place at another bank—with no money necessarily passing into accounts that can be linked to the money's owner. In recent years, al-Qaeda has also relied more heavily on cash, again with the aim that no financial trace be left. In any case, its units often finance themselves independently, through crime.

Where international efforts are unlikely to make much progress is in stopping small, cross-border money

transfers. In America, banks are required to notify the authorities of any cross-border movement of $10,000 or more—but not of lesser amounts. There are many hundreds of thousands of small payments every day. It would be a small matter to get a non-terrorist living in America to open an account on behalf of a terrorist friend. If Mr bin Laden can recruit 30 people willing to die on his behalf, notes Charles Calomiris, of Columbia University, he will have no problem getting 100 to open bank accounts.

In the end, only quite small sums of money were probably needed by the terrorists to pay for the recent devastation. It is also likely that much of this was brought across the border as cash. And likely that other money was raised in America, untraceable by the authorities, through that timeless American tradition: getting a credit card and running up debt.

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Correspondent banks

The weakest link

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An easy entry for illicit funds

REGULATORS only recently fingered correspondent banking as a weak point in the payments chain, through which illicit funds can enter. Earlier this year in America, the slackness of correspondent banking practices—failure to vet and block transfers of suspicious funds—was made public in Senate committee hearings. It embarrassed and humbled some of the biggest American banks into taking corrective action.

In Britain, the Financial Services Authority will have more powers, from December 1st, to prosecute negligent banks that are used for money laundering and cannot produce documents to show that they went through the proper controls. All the same, short of putting entire offshore-banking regimes beyond the pale, little can be done that does not involve, to a considerable degree, banks trusting in each other's due diligence.

Banks need correspondent banks in places where they do not have branches, for payments and other fee-based services. Diligent banks will vet their correspondent banks, in order to be confident that payments coming from them are sound. However, if the correspondent bank relays a payment from a third bank, the vetting process is weakened. “You can rely only so much on the institution you're dealing with: there will never be 100% certainty,” says John Byrne, senior counsel at the American Bankers Association.

The attacks on September 11th have brought into sharper focus the possible consequences of negligent correspondent banking. “Morally, perhaps, banks have a new role,” says a European regulator. Yet, while recognising this, most banks and regulators fear that little can be done that is not being done already.

The “know your customer” principle applies as much to banks as to end-users. Banks have already recognised the dangers of dealing with “shell” banks—that is, those without a physical presence in any country—and with banks in poorly regulated jurisdictions. But there is a risk of double jeopardy: the more that doubtful banks and banking systems are outlawed, the more attractive they are as an alternative network for transferring illicit funds. The answer is: keep trying to improve the system. “Correspondent banking is a risky but legitimate endeavour,” concludes Mr Byrne.

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Suspicious share dealings

Cut short

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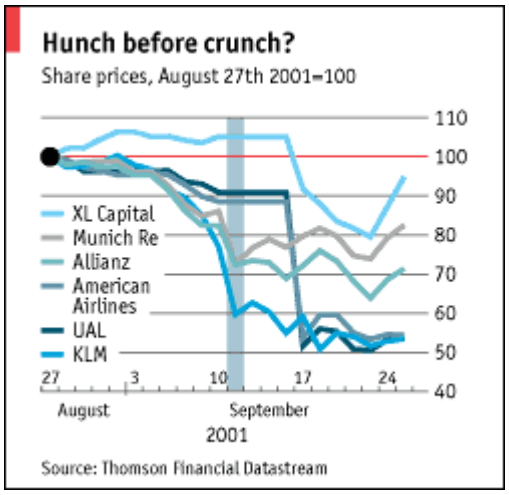
Was there foreknowledge of the attacks?

INQUIRIES continue into unusual financial activity before the attacks on America on September 11th. Trades under suspicion include the use of derivatives and the short-selling of shares in airlines, insurance companies and stock indices. Without hard evidence, regulators are wary about concluding that the markets were manipulated, although European financial leaders, including Ernst Welteke, president of Germany's Bundesbank, have referred publicly to signs of suspicious market movements. The last thing anybody wants is wrongly to credit the conspirators with financial-engineering skills.

Anecdotal material abounds. For example, one trader on the Chicago Board Options Exchange (CBOE) noticed two unusual trades, on August 6th and September 6th, in options on shares in United Airlines. The client bought a total of 675 put options (options to sell shares at a fixed price), an unusual size for such an illiquid market. After the attacks, United's share price plunged by 40%. That was surely time for the client to cash in his options, now worth around $750,000. The CBOE market-maker, Specialists DPM, has been poised to pay out. But nobody has called.



The trader thinks that the options were bought by somebody with foreknowledge of the attacks. He reported his suspicions to the CBOE on September 12th. If it was somebody close to the conspiracy, he may have intended to collect his winnings immediately, but could not because the market was closed. The trader has since heard of similar trades in airline and insurance stocks on three other American exchanges, worth several million dollars.

In Amsterdam, a firm of options brokers, IWB, executed orders to buy put options and sell call options on shares in KLM, the Dutch flag carrier, on several days in the week before September 11th. Two weeks later, exercising the options would have netted around $1m. Again, this was an unusual size for an illiquid stock. The orders came through a British broker, whose name IWB gave to the Dutch authorities.

In Germany, Belgium, Switzerland and Britain, regulators are looking at similar incidents. One plausible explanation, if suspicions prove justified, is that somebody on the periphery of the conspiracy decided to take a punt. A less palatable—but also less likely—version is that sophisticated financial dealing was orchestrated with the attacks on America, perhaps as part of the terrorists' financing.

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Wall Street gets back to business

Greed over fear

Sep 27th 2001 | JERSEY CITY
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Wall Street is not a place, rather a state of mind

AP

Relo Man

ON A back street in the warehouse district of Queens, across the East River from Manhattan, Frank Pastore sells Italian sandwiches from his cart to the same customers he once had outside the World Trade Centre—that is, members of the big commodity exchange known as the New York Board of Trade. In Jersey City, across the Hudson River west of Manhattan, the shoeshine men who plied Merrill Lynch's vast trading rooms in the World Financial Centre before it was damaged in the attacks on September 11th have seamlessly relocated to Merrill's back-up facility.

Sandwiches and shoeshines may not be a formal part of Wall Street's disaster-relief plans, any more than the copier, fax and computer sales and delivery men who have found their way to the temporary reception desks at Lehman Brothers, upstairs from Merrill Lynch. But all these people are helping to restore the securities industry to a semblance of what it was.

The reconstruction efforts are variations on a theme. At Lehman, thousands stare at computer monitors, undistracted as men wearing shirts with "Lehman Relo Team" on the back install new equipment from Cisco, Avaya and Lucent; a friendly, bomb-sniffing dog called Boris, newly liberated from New York's city courts, checks packages. The New York Board of Trade makes do more modestly. It operates out of a spartan building run by Comdisco, a "disaster-relief" company which, as it happens, recently went bankrupt. Other tenants are J.P. Morgan Chase and Royal Bank of Canada. The Board of Trade first rented space after the World Trade Centre was bombed in 1993, and the annual $300,000 in rent each year once made members wince. No other exchange, not even the New York Stock Exchange, had a back-up facility; conveniently enough, no other was destroyed.

The relocation efforts cannot come fast enough. Trading volumes in stocks, bonds and futures have been at levels to stretch systems even had they not been damaged by the attacks. Still, the volumes have a wonderfully salutary effect. One big investment bank admits to having its best week in at least half a year. Traders at the Board of Trade echo that. Even investment banking is looking up—perhaps not for long, if poor second-quarter results for most are anything to go by. Lehman Brothers has underwritten two huge debt issues for GE, as well as a big issue for Campbell Soup. It has also advised on several acquisitions. Merrill has underwritten the first equity financing since the disaster, for Allied Capital, a private-equity firm. It even floated a bond offering for American Airlines at the hardest time possible.

It would be a stretch to suggest that the New York financial markets have, in any full sense, recovered. The emotional devastation is great. In the afternoons, staff numbers thin as people slip out for memorial services in Connecticut, New Jersey and New York. Even the most focused staff, their colleagues say, are found staring into space. The biggest firms have provided counselling services for their staff.

Operating conditions are far from ideal. There is only one trading pit at the reconstituted Board of Trade, so each commodity may be traded for just 1½ hours each day. Few, if any, businesses in and around New York have escaped trouble with telephone and Internet connections. More than 20m square feet of New York's best office space has been destroyed; new leases are being signed daily, but there are inevitable bottlenecks. Even the tiniest rooms have multiple tenants. Tom Davis, president of Merrill Lynch's institutional business, shares a Jersey City office with three people from the fixed-income department and two secretaries. Reflecting the mood of the moment, Mr Davis says, "no one is complaining." At least not to him.

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About sponsorship

World stockmarkets

Cheap, but not cheerful

Sep 27th 2001
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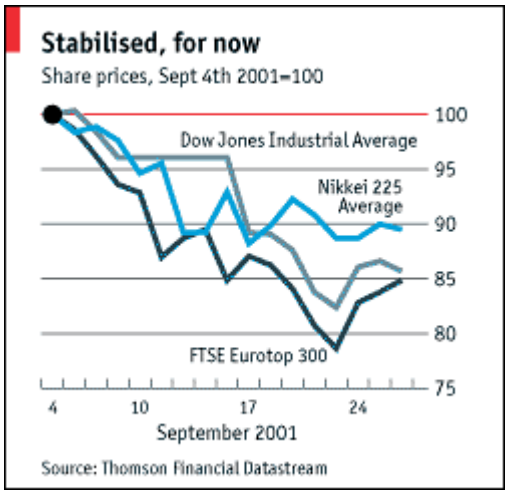
War? Recession? Investors have battle fatigue

AFTER one week in which the Dow Jones Industrial Average fell by its biggest amount (14%) since 1933, the dread of war seemed forgotten by the markets in the next. Oil prices slipped sharply, suggesting greater concern about recession than about the disrupting effects of conflict. For American equity investors, on the other hand, little seems to shock any more. Once, share prices were marked savagely down whenever a company came out with bad news. But when AOL Time Warner sharply lowered its growth prospects on September 24th, because of a slump in advertising, its shares hardly budged. Appalling consumer-confidence figures the next day also elicited a jaded response. That's progress, of sorts.

America's broader indices have fallen by over one-third from their peaks. They have only to fall by another 10% or so for them to be no more highly valued, in terms of price/earnings (p/e) ratios, than they were after the crash of October 1987. The problem, now, is what analysts call earnings "compression": the danger that future earnings will fall by more than expected, so pumping up p/e ratios again. Much rests on whether the consumer, atop his pinnacle of housing and credit-card debt, will keep up spending. There is also the danger of forced selling, by investors having to meet margin calls or redemptions.

European stockmarkets have fallen further than have American ones in the past couple of weeks (see chart), and by about two-fifths from their collective peak—a decline equalled only once before in the past half-century. Morgan Stanley says its valuation model for European equities is as good as at its all-time low. At that level, the risks of equity investment should be low. But so, too, may be the prospect of a strong rally, given the harm of an American recession to the European economy.

In Japan, share prices followed America's down after the attacks. Local concerns remain. The yen has failed to weaken by much, despite unsterilised intervention by the central bank. Bank shares suffered big losses after the government unveiled another reform timetable for the economy, which failed to address the worsening bad-debt problem at the banks. Earnings downgrades, coming thick and fast, still seem to catch investors out.



Elsewhere in Asia, though, some shares are screamingly cheap, notably in South Korea, Taiwan and even Hong Kong. Bear in mind that Asia's crisis began fully four years ago. Asian economies and companies are now not heavily indebted, unlike America's. Banks are flush with deposits, though short of lending prospects.

At the first sign of an upturn in rich-world economies, it is plausible to imagine, Asia's stockmarkets might soar. Just as these markets on the periphery were the first to show signs of strain, so they might be the first to mark a recovery.

A sign of stockmarket value in Asia used to be when the shares of HSBC, Hong Kong's banking giant, yielded more than the rate the bank offered on deposits. This week, yielding nearly 5%, HSBC's shares do so once again. The bank's chairman, Sir John Bond, says he's always known what to do.

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About sponsorship

Terrorism and insurance

Risk's new dimension

Sep 27th 2001
From The Economist print edition

The government as insurer of last resort?

THE attack on the World Trade Centre has changed, perhaps lastingly, perceptions of risk. It was the worst terrorist assault on American soil, producing the biggest insurance losses in history and the highest death toll in any insured event. The odds of terrorist attacks may not necessarily be any higher. But the fear of them certainly is. So, too, is the demand for insurance cover. Good news for insurers? Only for the brave few willing to underwrite “exotic” risks”—such things as terrorist attacks or actresses' legs. But war risks, or the risk of nuclear attack, find no takers. In most countries, governments are supposed to pay for the costs of war.

Immediately after the attacks on America, cover against terrorist acts became the risk that nobody wanted. Insurers immediately increased airlines' premiums and cut their cover for third-party war and terrorism liabilities to a maximum of $50m per airline, per “event”. Under pressure from airlines threatening to ground their fleets, European Union governments agreed to provide temporary cover for a month, including liability for damage on the ground. The American government, too, has become the insurer of last resort. On September 21st Congress passed an emergency act promising to repay American airlines for the added insurance cost over the next 180 days, as well as to cover, for the same period, airlines' war and terrorist liabilities when they exceed $100m.

A few insurers now say they will be prepared to offer the necessary insurance for airlines. American International Group (AIG), the country's biggest insurer, said on September 25th that it hopes to be able to offer coverage for war and terrorism, for up to $1 billion per airline. Yet any coverage will come at a high price. Michael Frinquelli at Renaissance Fund Advisors, a hedge fund in New York that invests in insurance companies, says that, without government involvement, airline premiums would by now have risen up to tenfold. Even with the government's relief package, they will probably triple.

Should the American government permanently become insurer of last resort? Maurice Greenberg, head of AIG, and Warren Buffett, chairman of Berkshire Hathaway, an insurance-heavy conglomerate facing many claims from the attacks, think so. Kenneth Arrow, a Nobel-prize-winning economist, argues that incomplete markets for risk are one of capitalism's greatest failings and advocates government intervention. But efficient-market purists hold out. “There is an accurate rate for terrorist risk,” says David Schiff, at *Schiff's Insurance Observer*, a New York newsletter.

European governments are far more experienced in reinsuring man-made catastrophes

As it is, David Moss of Harvard University points out, American state governments already act as insurers of last resort in other areas, through state guaranty funds. These funds guarantee policyholders' claims when insurers are insolvent. They are generally not financed by premiums, but are “post-assessment”. That is, insurers pay into the state guaranty fund after one or more insurance firms in their state have gone bust.

European governments, as well as Israel, are far more experienced in reinsuring man-made as well as natural catastrophes. In 1993, after a series of bombings on mainland Britain by the Irish Republican Army, a government-backed, mutually owned company, Pool Re, was set up. Insurers collect premiums for terrorist insurance, and the government chips in if claims for terrorist attacks exceed the pool's premiums plus reserves. France has a state-guaranteed reinsurer, the Caisse Centrale de Réassurance. It kicks in when private insurers' losses from policies for natural disaster exceed 150% of premiums. The Israeli government covers direct losses from terrorist attacks, although not for business interruption.

Do insurers need the American government as the ultimate guarantor for terrorist risk? They might

prefer it to be the ultimate guarantor of the stockmarket. The fall in equity markets since September 11th has knocked more than twice as much off insurers' world stockmarket capitalisation as the estimated $30 billion insurance cost of the terrorist attacks.

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About sponsorship

The IMF and the World Bank

Bribing allies

Sep 27th 2001 | WASHINGTON, DC
From The Economist print edition

The IMF and the World Bank become part of America's anti-terrorist arsenal

AMERICA has lost no time rewarding its new allies in the war against terrorism. In the past week it has lifted economic sanctions on Pakistan and India, rescheduled $379m of Pakistan's bilateral debt, offered to expand Indonesia's special trade preferences and passed a long-delayed free-trade agreement with Jordan. More bilateral help for allies is likely. And, if the past is any guide, that will not be all. The IMF and the World Bank will also be under pressure to increase help for America's new friends and to come down hard on its enemies.

In some cases, that means that efforts at economic reform will get a boost. In Pakistan, for instance, a one-year, $596m loan programme with the IMF is about to end. Since the government has made quite good economic progress, this loan was likely to be followed by another, more concessionary, loan even before the September 11th attacks on America. Now, a second loan is certain, and its probable size is likely to be far bigger (officials in Islamabad talk of $2.5 billion).

Pakistan will also probably get more relief on its $37 billion of external debts, $13 billion of which is owed to rich-world governments. Until recently, the Paris Club of official creditors had discussed only a modest rescheduling. Now, big write-offs of debt are on the cards. Egypt's official foreign debt was cut in half in 1991, partly as a reward for its help in the Gulf war. Jordan, another Middle Eastern reformer, may also suddenly find the IMF more generous. It is in the last year of a three-year, $164m loan programme. For a new American friend, a sizeable successor loan is assured.

America's new allies are not all countries trying to pursue sensible economic policies. Uzbekistan is a nasty dictatorship with scant regard for human rights and no interest in economic reform—though it is keen on loans from the IMF. Earlier this year, the IMF pretty much gave up on the place and dropped any resident representative. But now that American troops are heading for Uzbekistan, the Bretton Woods institutions may find it hard to ignore requests for cash. Indeed, staff at the World Bank are already thinking of potential projects in Uzbekistan and other central Asian countries—in case they have to lend a lot of money fast.

The IMF and the World Bank are no strangers to lending driven by political considerations. Throughout the cold war, both organisations were a favourite tool for helping useful, if unsavoury, regimes: Mobutu's Zaire, for instance. The history of such lending is dismal. Although the World Bank may this time find useful things to spend the money on—coping with large numbers of Afghan refugees for instance—much of it is likely to be wasted.

Using the Fund and the Bank to punish potential American enemies is hard

Using the Fund and the Bank to punish potential American enemies is harder, since few have any ties with the two institutions. The IMF has had no dealings with Afghanistan since 1991 (though that could quickly change if the Taliban regime is toppled and another more to America's liking is installed). Sudan is an interesting case study. It has long been one of the IMF's worst debtors: a few years ago its voting rights as a member were suspended, because it was so far behind in its repayments. Recently, though, Sudan has been improving its standing. It could even be eligible for new loans within a few years. Whether that happens depends as much on Sudan's reputation for harbouring terrorists as on its economic policies.

Formally, America cannot direct IMF policy, since it casts only 17% of the board's votes. In practice, it puts huge pressure on other rich countries to follow its lead. In 1998, for instance, Croatia was denied an IMF loan payment, even though its economic policy was deemed sound by the technocrats, because it had failed to hand over war criminals. But such political decisions come at a price: they undermine the

Fund's credibility as a purely economic institution. In recent years, political interventions have been mercifully rare. That looks about to change.

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Pakistan's economy

What now?

Sep 27th 2001 | ISLAMABAD
From The Economist print edition

Things were looking up

AP

Can't blame the generals for the drought

GENERALS are good for Pakistan's economy: it's official. Since Pervez Musharraf seized power in a military coup two years ago, the government's fiscal deficit has come down, foreign-exchange reserves and exports have stabilised and, possibly for the first time in history, the IMF's lending programme to the country is going forward without a hitch. A debt junkie of long standing (public debt is more than 100% of GDP, and foreign debt is about $37 billion), Pakistan had begun to reform itself.

Now that Pakistan finds itself suddenly on the front line of the war against terrorism, it is easy to see how reform might go awry. Governments are loth to insist that fuel prices be increased and bureaucracies slimmed even at the best of times. In Pakistan's case, normal disgruntlement could be sharpened by the government's fragility during possible attacks on neighbouring Afghanistan.

And austerity has not done the economy much tangible good. Growth fell to a dismal 2.6% in the fiscal year ending June 2001, due mainly to a drought that depressed agriculture. Nor has reform tempted investors: gross fixed-capital investment by the private sector fell in nominal terms in the same fiscal year. Poverty has been rising. In 1992 some 20% of Pakistanis could not afford to feed themselves adequately; by last year that had risen to 30%.

Now Pakistan faces a possible influx of hundreds of thousands of Afghan refugees. Add to that a worldwide economic slowdown that threatens to crimp its exports, making it harder for Pakistan to escape its debt trap. Some airlines, including Lufthansa, have even stopped flying cargo in and out of the country.

Mueen Afzal, secretary-general of the Finance Ministry, argues that the government is still “totally committed” to reform. Decisions on price increases for fuel and electricity have been removed from government discretion, although there might be scope for delaying a planned reduction in gas subsidies to domestic consumers. Gainsaying IMF officials, there is no reason yet, the government says, to ask for more lenient targets from the IMF.

The crisis has its bright spots. America has dropped sanctions related to Pakistan's nuclear tests in 1998. Next to go may be penalties imposed in 1999 for its discarding of democracy. Mr Afzal denies widespread speculation that Pakistan is seeking a write-off of some of its bilateral debt. It would, he says, prefer additional loans and to build up its foreign-exchange reserves. Pakistan has long wanted more open markets from the West, particularly for textiles. Now, it might even get them.

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Economics focus

Going downhill

Sep 27th 2001
From The Economist print edition

Many economists reckon the world is sliding into recession. The IMF disagrees

SOME years ago *The Economist* mischievously suggested that IMF stood for "Infuriatingly Misleading Forecasts". In fact, the Fund's record is probably no worse than most others, dismal as that is. However, the IMF's latest forecasts in the *World Economic Outlook*, published this week, seem especially complacent. The forecast of world GDP growth is 2.6% this year and 3.5% in 2002. One big problem is that all the forecasts were finalised before September 11th. The Fund concedes that growth is now likely to be slower, as confidence weakens, but it remains cautiously optimistic.

Comments over the past week from Horst Köhler, the IMF's boss, and Anne Krueger, his deputy, and by Ken Rogoff, its new chief economist, have made clear that they still do not expect a world recession. There is no precise definition of "world recession" (global output has risen in every year since the 1930s), but it is generally taken to be growth of less than 2-2.5%.

The IMF argues that, given the huge uncertainties involved, it is premature to quantify the impact of the attack on the American and world economies. Fair enough. But the uncertainties within the IMF seem almost as big as those outside. At this week's press conference, Mr Rogoff responded to a question by saying that an American recession was "a done deal". But he later withdrew the remark, saying instead that it was too soon to tell.

The IMF's forecast of 1.3% growth in America in 2001 implies that output will be broadly flat in the second half of the year. It would not take much to turn that into recession. Indeed, recent data suggests that the economy may have slipped into recession even before the terrorist attack. A majority of economists now expect America's GDP to contract in both the third and fourth quarters of this year.

A V-shaped or U-shaped recession?

The big divide among economists is no longer over whether there will be a recession in America, but over how deep it will be. A popular argument among optimists is that a V-shaped recession and recovery—as opposed to a more prolonged U-shaped recession—is now more likely, thanks to lower interest rates and looser fiscal policy. Their conclusion: share prices, as well as demand, will soon bounce back strongly.

A V-shaped recession may indeed be more likely, but that is mainly because of a much sharper downward leg than had previously been expected. Even if growth bounces back next year, the level of output at the end of 2002 will probably be lower than might have been expected a few weeks ago.

Furthermore, one reason for expecting a U-shaped downturn, with a sluggish recovery, was that overcapacity and high debt burdens would make firms less likely to invest more in response to lower interest rates. But a steeper drop in demand will now make overcapacity worse. Meanwhile, the impact of lower interest rates on households is being offset by falling share prices.

America's broadest share index has fallen by almost 40% from its 2000 peak. That sounds modest compared with the 85% plunge in the three years after 1929, but the stockmarket plays a bigger role in the economy today. The loss of equity wealth over the past 18 months is equivalent to 75% of GDP, a bigger proportionate loss than after the 1929 crash.

No match

Economists like to draw analogies between now and the Gulf war, which also helped to push a weakening American economy into recession. But there is one big difference: unlike today, in 1990-91 Japan, the euro area and most emerging economies were growing briskly.

The euro area grew at an annual rate of only 0.2% in the second quarter and the third quarter looks sluggish, with industrial production falling by 1.4% in July. Consumer-confidence figures for the Netherlands, the first European survey to be carried out since the American attacks, showed a plunge. Morgan Stanley expects the euro area to contract in the fourth quarter and to grow only slightly in the first quarter of 2002. If so, the euro zone will only narrowly escape a recession.

In contrast, Morgan Stanley now expects Japan's economy to contract for four consecutive quarters until next spring, with GDP falling by an average of 0.8% this year and next. The bank forecasts average growth in the rich economies of only 1% in 2001 and 2002. Add in the many emerging economies that are also stumbling and Morgan Stanley reckons that global growth will slow to 1.8% this year and to 2.1% in 2002. That is well below the IMF's numbers—and it would count as a world recession.

To be fair to the IMF, its economic analysis is stronger than its forecasts. In a special section in the *Outlook*, it explores how increased linkages between economies through trade, foreign direct investment and financial markets have made this business cycle more synchronised than previous ones. An adverse shock in America now has a bigger impact on the rest of the world than it did. The synchronised nature of this downturn, says the IMF, has increased the vulnerability of the global economy to shocks.

Another new channel through which economic shocks are transmitted between economies is business confidence. The IMF finds that measures of business confidence in America and Europe have become more synchronised in recent years, and by much more than can be explained by correlated movements in economic activity. European businessmen seem to pay more attention to American business confidence. Traditional economic models fail to take full account of these growing linkages. This partly explains why earlier this year the European Central Bank underestimated the impact of America's slowdown on the economies of the euro area.

The terrorist attacks increase the risks to an already sick world economy, yet they may help to avoid a world depression. John Makin, an economist at the American Enterprise Institute, argues that the crisis could encourage overly cautious policymakers to cast aside foolish fears about inflation and to pursue more aggressive monetary and fiscal easing. Are Japan and Europe listening?

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The environment

Economic man, cleaner planet

Sep 27th 2001
From The Economist print edition

Shocking as it may seem to most anti-globalists, market forces can help the environment. In fits and starts, they are already starting to

“THE foresighted utilisation, preservation, and/or renewal of forests, waters, lands and minerals, for the greatest good of the greatest number for the longest time.” That, insisted Gifford Pinchot, a founder of America's conservation movement, should be the proper goal of greenery. Decades after he penned those words, his sentiments still inspire.

Sadly, that is because the world's approach to environmental protection has mostly failed to heed Pinchot's call for wise use of resources. Instead, governments everywhere have tended to follow a heavy-handed “command-and-control” approach that sets impossibly lofty environmental goals and requires needlessly expensive responses or rigid technological fixes. In America, these came in the shape of a wave of federal environmental laws passed three decades ago, around the time of the first Earth Day. Most of the world then followed the same path.

The legacy of this “mandate, regulate and litigate” approach is mixed. It is true that it has helped to bring about environmental gains: by most measures, air and water in the rich world are cleaner than they were three decades ago. Yet, even as the actual air has got cleaner, the metaphorical atmosphere has been poisoned by the confrontational approach enshrined in such laws. For decades, the prevailing attitude of governments' environmental agencies, especially in America, seems mostly to have been one of hostility to industry. The resulting policies encouraged litigation and stifled innovation.

Dan Esty, a professor of environmental law at Yale University, says that the laws “often looked disapprovingly at human activities and economic growth because of their harmful pollution side-effects, which were thought inescapable...prospects for further progress on the same path are limited.” He has been developing “next generation” reforms, which favour incentive-based, market-oriented policies. Greens and anti-globalisers may not like this; but the result could hugely improve the environment, at much less cost.

The cost of command-and-control

Three principal failings of the status quo are driving the new green revolution: yesterday's failed ambitions, today's large price tag and tomorrow's even harder targets. The command-and-control approach has not proved all that effective in curing yesterday's ills. Although air and water quality have indeed improved dramatically, other environmental problems—from waste management to hazardous

releases to fisheries depletion—have not.

Even gains have come at a needlessly high price

Moreover, these top-down laws are inefficient, meaning that even the gains that the world has seen have come at a needlessly high price. Typically, the reason for this is that the laws have specified particular technological fixes so as to achieve outcomes that are pre-ordained, with little consideration for local environmental conditions or for the marginal cost of pollution abatement at individual companies. Another failing has been that cost-benefit analysis, a common-sense tool of economics that is suited to environmental matters, has not been widely used. Indeed, in many cases, America's Congress has expressly, and perversely, forbidden its use in environmental policymaking.

The most glaring example of what can go wrong has been America's Superfund scheme, which sought to clean up toxicwaste sites through tough federal laws. For all the nobility of its aims, Superfund has proved bureaucratic, costly and largely ineffective. The scheme often set standards so high (clean enough for toddlers in a theoretical nursery located on the site to eat the dirt, even if the dump was in an industrial park) that many polluted sites were never cleaned up at all. The scheme invited litigation: Superfund has cost billions of dollars, but over half the cash has lined the pockets of lawyers. Worse, according to “Superfund's Future”, a new book from Resources for the Future (RFF), a Washington-based think-tank, the scheme will cost America another $14 billion-16 billion over the next decade.

This dirigiste approach to the environment is now under attack not only because of its past failings but because it is woefully inadequate to the task of dealing with tomorrow's environmental problems. One reason is society's ever-rising expectations: the green goal-posts keep moving. Also, scientists now have a better understanding of mankind's impact on the environment, which often brings to light unobvious, complex problems. The link between an obscure chemical used in hair spray and a hole in the ozone layer, for example, or the relationship between carbon dioxide and climate change, are harder to understand and to tackle than the concerns of three decades ago, when Cleveland's filthy Cuyahoga river spectacularly caught fire.

Slowly but surely, governments around the world are rethinking the command-and-control approach. Instead, they are tinkering with various types of market-based policies, ranging from green taxes to tradable permits to pollute. If they stick with it, such economic instruments would harness the power of the market for the sake of the planet's health. This could prove nothing short of a revolution.

Enter the market

Market-based greenery differs from the conventional sort in that it tries to influence behaviour by altering price signals, rather than through regulations that spell out desired pollution levels or impose particular pollution-control technology. The great weakness of the conventional approach is that it gives companies so little leeway in how they meet pollution targets. That means they cannot respond to local differences, and tends to lock in old technologies and stifle innovative approaches to improving the environment.

Robert Stavins, an environmental economist at Harvard University, argues that market instruments do precisely the opposite: since it often pays to clean up if a sufficiently low-cost process or technology can be identified, such policies can prove a powerful stimulus to both greenery and innovation. There are dozens of variations on the theme, but Dr Stavins divides market instruments into four broad categories: tradable permits, charging systems, cuts in government subsidies and the lowering of market barriers.

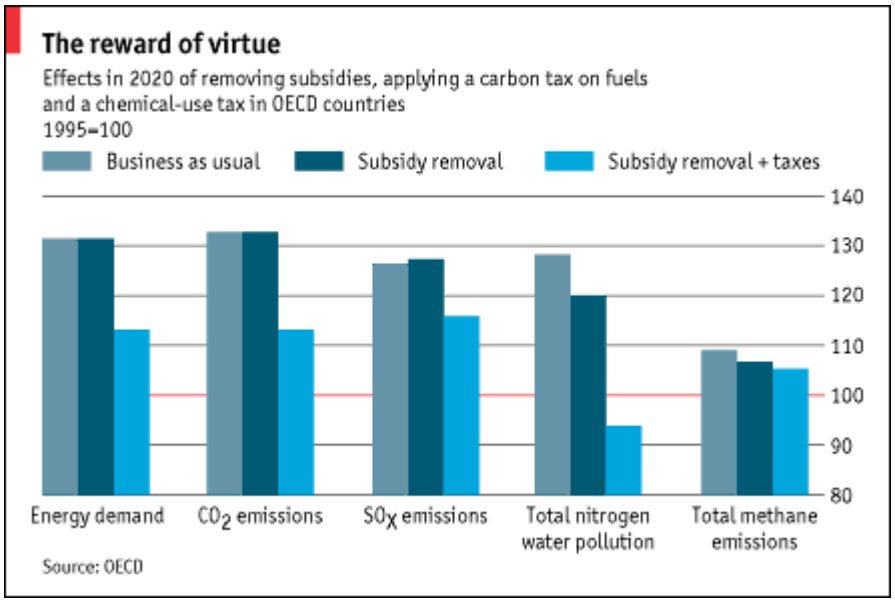
In a typical **tradable permit scheme**, a government decides upon acceptable levels of pollution and allocates credits for meeting those limits among companies. Those that can cut pollution at the lowest cost will have spare credits to sell; those with high abatement costs can then buy from them. Successes to date include the trading of chlorofluorocarbons under the international Montreal Protocol (designed to save the ozone layer) and the use of particulates trading in Chile.

However, it was America that led the way. The greatest environmental success story of the past decade is probably America's sulphur dioxide scheme, aimed at reducing acid rain. A decade ago, George Bush senior introduced this then-controversial plan, inspired by a trail-blazing scheme in Wisconsin, to control and “ratchet down” the emission of sulphur dioxide from power plants. The key was the introduction of tradable rights, combined with a credible threat of punishment for non-compliance. This spurred the development of a vibrant market and lowered emissions beyond expectations. Analysts at RFF reckon that, compared with doing the same thing using command-and-control, it has saved $1 billion a year.

America may have led with trading, but it has been a laggard in other market reforms. When it comes to using **green taxes and charges** to alter the prices of goods and services to reflect their environmental effects, Europe has generally gone the furthest. Led by Scandinavia, Europe is embracing comprehensive reforms that shift taxes away from labour to specific environmental harms.

A report published this week ("Environmentally related taxes in the OECD") argues that this is generally a good trend. The OECD's researchers conclude that there is growing evidence that such green taxes actually work. Sweden's experience is telling. In 1991 the country introduced a sulphur tax: this led to a drop in the sulphur content of fuels to 50% below legal requirements, and stimulated power plants to invest in abatement technology. Norway's carbon tax, also levied in 1991, lowered emissions from power plants by 21%.

The only unkind word that experts have for such green taxes is that they are too often blunted by blanket exemptions or rebates granted to heavy industry—an example of corporate welfare that is sadly too common in the environmental realm. The **reduction of environmentally harmful subsidies** is more essential than ever. Such subsidies are lavished on everything from pesticides (to make them cheap for farmers) to water (often free for both farmers and city-dwellers) to electricity (underpriced for almost everybody). The OECD reckons that, if its members embraced a carbon-based fuel tax along with a tax on chemical use, and eliminated harmful subsidies (see chart), it could improve its environment dramatically for a very modest price: less than 1% of one year's GDP. Poor countries would benefit even more, since they typically waste even more money on damaging subsidies.



The fourth sort of innovative approach involves **reducing barriers to the creation of new markets**. A simple, yet powerful application of this is to require the disclosure of information. Once equipped with information on the greenness of companies, the argument goes, consumers can vote with their wallets.

Europe has had eco-labelling schemes for some time, most notably Germany's Eco-Angel programme. In America, the Toxic Release Inventory requires companies to publish their emissions of more than 350 chemicals. Using these once-obscure data, "environmental justice" groups have created Internet sites into which anybody can punch in a postal code and find out how dirty the neighbours are.

The biggest bang may have come with Indonesia's "Proper" programme. As in most poor countries, local officials there had little money to enforce existing pollution laws; violation has been the norm. With the help of the World Bank, they have now designed a five-tiered scheme that ranks companies by sector—from gold for going beyond compliance to black for flagrant violations. They publicly applauded the few top rankers, and gave the worst offenders six months before their names would be made public. Astonishingly, most of the defaulters have rushed to invest in abatement technologies and otherwise clean themselves up for fear of public censure. The Proper scheme is now being adopted by the Philippines and by several Latin American countries.

What about the poor?

This anecdote also points to something else that anti-globalists hate to acknowledge: that developing countries have the most to gain from market reforms in the environmental realm. The anti-globalisers, by contrast, argue that growth and trade are enemies of the environment.

That may appear true in a wholly static world, where every new factory may well do some harm. However, the world is anything but static: each environmental impact is mitigated by far more powerful forces. For a start, trade spurs economic growth, which is the ultimate guarantor of greater environmental protection: history shows that, as people get richer, they begin to demand a cleaner environment—and can afford to pay for it. What is more, trade liberalisation exposes filthy and inefficient domestic industries to competition, and attracts foreign direct investment; these in turn spur investment in newer, and therefore cleaner, technologies.

Anti-globalists also worry that liberalisation will lead to a "race to the bottom", as poor countries lower their environmental standards in a contest to attract foreign investment or to set up sweatshops. That is wrong, on two counts. First, trade agreements (and the World Trade Organisation, for that matter) do not stop countries from pursuing whatever levels of greenery they wish; in fact, there is great variation, even among countries at comparable levels of economic development. Second, as the World Bank recently concluded after six years of study, "pollution havens—developing countries that provide a permanent home to dirty industries—have failed to materialise. Instead, poorer nations and communities are acting to reduce pollution because they have decided that the benefits of abatement outweigh the costs."

Anti-globalists worry that liberalisation will lead to a "race to the bottom" in environmental standards. They are wrong

What is more, history also shows that countries that have embraced free trade have seen their environments improve along with their economies, while those that closed their economies have fouled their air and water even as their economies stagnated. From the Soviet Union to China to India, centrally planned or closed economies have a pitiful environmental legacy that is only now being reversed as entire sectors are privatised and opened to competition and investment.

This is especially true in water and waste treatment, which have been among the first businesses that most poor countries have opened up to foreign investment. Water infrastructure is so expensive that governments have left over a billion people without safe water or sewerage. Happily, liberalisation has attracted tens of billions of dollars in investment to over 60 developing countries. Some home-grown multinationals from developing countries are even emerging.

Of rights and wrongs

Given such impressive advances, it might seem that market forces have already triumphed. Not quite. In fact, market purists are deeply sceptical of even the inroads made so far. Jonathan Adler, a professor of law at Case Western Reserve University in Ohio, reckons that most people who gush about economic incentives these days are merely "*faux* market environmentalists". For such market advocates, even the most radical reforms proposed by the next-generation crowd do not go nearly far enough. What they want is a dramatic shift to a policy grounded in private property rights.

Free-market environmentalists argue that the incentives and markets created by such rights will protect the environment better than any amount of government meddling. This philosophy hinges on the idea that secure property rights create incentives for individuals to be good custodians of nature. Private ownership makes it possible for green groups such as Ducks Unlimited and the Nature Conservancy to buy and preserve pristine bits of wilderness. The assignment of freely tradable property rights over water flowing in rivers has allowed green groups such as Environmental Defence or Oregon Water Trust to save endangered fish by buying water from farmers on behalf of their aquatic friends.

The absence of property rights often leads to a "tragedy of the commons", with users overexploiting an otherwise renewable resource before their unconstrained competitors can do so. This is what has happened to offshore fisheries. Most of the world's fishing grounds are greatly depleted by over-fishing. All fishermen would benefit in the long-term from a thriving fishery. But each acting in his own short-term interest will catch as many fish as he can. A few path-breaking schemes, in New Zealand, Iceland and parts of America, have assigned fishermen rights to an assigned quota (set at a sustainable level), and allowed them to trade that quota freely. The result: stocks are reviving.

Such talk makes many traditional environmentalists nervous. Carl Pope, the head of the Sierra Club, a

big American green group, rejects the philosophy of the free-market radicals as simplistic. He insists that free marketeers gloss over a fundamental question: “Who has property rights over the commons?” He points to climate change, and the thorny question of how to allocate and achieve global cuts in emissions of carbon dioxide.

However, even Mr Pope does not reject market forces out of hand. He accepts that economic incentives can play a part in the policy mix: “the dialogue about what we should do is a silly one—we should use every possible incentive to help the environment.” He argues that markets would not help to protect migratory birds that travel thousands of kilometres, but acknowledges that they may help to restore fisheries. In sum, he would like to have command-and-control rules as the main course, but sprinkle in a bit of market forces for flavour.

The snag is that the two methods are often incompatible and so cannot easily be combined. If you impose overly detailed regulations, you may make it harder, not easier, to harness the market to your ends. Dr Adler's rebuttal of such “third way” arguments is blunt: “It was the fatal conceit of socialism, in Hayek's famous phrase, that wise government bureaucrats could guide society to a better future. Substituting red aspirations with green ones does not change the undertaking's essential nature—or its likelihood of success.”

Libertarians and deep greens can perhaps agree on one thing: whether for good or ill, market forces are only just beginning to make inroads into green policymaking. Dr Stavins cautions that while economic instruments may seem all the rage today, “this should not leave the impression that market-based instruments have replaced, or have come anywhere close to replacing, the conventional, command-and-control approach.” Even if current trends continue, it will take a while before the balance tilts toward the more innovative approach.

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About sponsorship

Lessons from the Great Depression

All too familiar

Sep 27th 2001
From The Economist print edition

The Great Depression, one of the 20th century's worst calamities, brought an earlier era of globalisation to an end. Could it happen again?

SUDDENLY the publication of this book looks even more pertinent than its author or anybody else could have wished. “The End of Globalisation” is a study of the origins and consequences of the Great Depression, set in the context of today's debate about the stresses and strains of globalisation. It asks, what do the economic and political catastrophes of the 1930s tell us about the prospects for the global economic order at the start of the 21st century? What are the dangers, and what might be the remedies?

Hulton Getty

The End of Globalisation: Lessons from the Great Depression
By Harold James

Harvard University Press (June 2001); 270 pages; $39.95 and £27.50

Buy it at
Amazon.com
Amazon.co.uk

The author, Harold James, a professor of history at Princeton University, is an eminent scholar in the political economy of the period. The breadth and depth of his knowledge are apparent throughout the book, but never burdensome. The study is crisp and comparatively short, intended as much for the general reader as for other historians. With any luck it will reach many of those hoped-for readers. It would be hard to think of a better instance of the right book on the right subject published at the right time.

Mr James's main theme is that globalisation cannot be taken for granted: it may slow down, or even retreat, as it did with such calamitous results in the 1930s. And it may do so again now.

The book disagrees with the view that it took the Great War to produce the Great Depression. Mr James argues that the international economic order of the late 19th century in any case contained severe and possibly fatal flaws. These included growing demand for trade protection and mounting hostility to immigrants. More broadly, the author argues, popular expectations about what states and societies might do to soften the impact of economic integration had created a burden that politics could not support. Mr James does not predict a new depression (there are no fatuous forecasts here), but he denies that you need a global war to get one.

What the author could not have anticipated was that today's frictions include not just the protectionism, resentment of immigrants, financial fragility and overburdened polities of the late 19th century, but the prospect of war as well. This makes the book's examination of the other parallels, worrying enough in themselves, all the more chilling.

After the Great War, hopes for a new spirit of internationalism soared in the 1920s. Later, after the fragility of international finance had helped to turn a slump into the Great Depression, those hopes were repudiated: the fears and nationalistic resentments of the late 19th century revived in a new and much more virulent form. Today, even after years of unparallelled economic success in the West, similar fears and resentments are expressed; and now the world contemplates the twin spectre of global recession and violent conflict leading who knows where.

The 1930s smashed the Geneva consensus; will this decade destroy its not-so-distant descendant, the Washington consensus, and with it the idea of international economic co-operation? Though it would be rash to rule this out, Mr James offers some grounds for optimism.

One resides in, as he writes, “the difference between an order imposed by treaties and an order built in sustained reflection about appropriate policy—and the gains to be derived from it.” In the 1920s internationalism was imposed; after the 1960s it developed, in the main, spontaneously, “as a result of calculations about advantage”. That seems right, though today's anti-globalists would deny it. In their view, the Washington consensus is also imposed, selfishly and undemocratically, on unwilling victims. If that were true, the portents really would be bleak.

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Napoleon and Wellington

Fighting words

Sep 27th 2001
From The Economist print edition

Napoleon and Wellington.
By Andrew Roberts.
Weidenfeld & Nicolson; 350 pages; £25

The Man Who Broke Napoleon's Codes: The Story of George Scovell
By Mark Urban

Faber and Faber; 352 pages; £16.99

Buy it at Amazon.co.uk

PROBABLY no general has received so much intelligence about his enemy as the Duke of Wellington when he fought the Peninsular campaign during the Napoleonic wars. That intelligence began at the Spanish frontier, at Irun, where a cobbler sat in the doorway of his shop and counted the French battalions coming in and the survivors going out. All his observations reached Wellington, as did countless reports from a superbly mounted band of exploring officers and a myriad of Spanish and Portuguese *guerrilleros*, who made travel for French couriers a nightmare. Dispatches were sent in triplicate because the French knew some would be captured and, naturally, the documents were in code. For a time almost everyone in Wellington's headquarters, from the general downwards, turned their hand to decoding. One officer, George Scovell, made it his speciality, and now Mark Urban, the BBC's diplomatic correspondent, recounts Scovell's exploits in “The Man Who Broke Napoleon's Codes”.

Warfare, espionage and codes are good hunting grounds for writers. The problem here is that not much is known about Scovell who, anyway, did not greatly affect the course of the war with his successful decryptions. Mr Urban gallantly attempts to show that Wellington would not have fought at Salamanca without reassurances gleaned from Scovell's work, but the claim is not convincing. Wellington probably knew more of the French dispositions than did the writers of the intercepted dispatches. This is not to say the decoded letters were of no value. But nor is it true to say that they were Wellington's chief source of intelligence, or, as the book's title implies, that it was Scovell alone who broke the French codes. There was a secret deciphering office in London, a successor to the Post Office's foreign letter office, and another code-breaking unit in the Admiralty, both of which cracked Napoleon's codes, as did the *bureau noir* attached to every European government (though the Austrians reckoned their best intelligence came from the emperor's pillow talk).

Scovell was at the sharp end of the war and unable to draw on expertise from London, and he did well with limited resources. But he did not do enough to fill a book. Mr Urban expands his hero's achievements with some first-class descriptions of the campaign and its battles, but he might have done better to have remembered that patient cobbler in Irun and written a book describing the whole intelligence apparatus available to Wellington.

There was no cobbler to count the French battalions crossing the frontier towards Brussels in 1815. Napoleon and Wellington, the premier soldiers of their age, were about to meet for the first time, and Andrew Roberts, in his “Napoleon and Wellington”, reveals that Wellington, at least, was aware that it would be a battle of reputations as well as a clash of nations. Mr Roberts, for whom this is a first excursion into the Napoleonic period, hit upon the interesting idea of teasing out what the two generals thought of each other. “Thank God I have met him,” Wellington said fervently afterwards. Napoleon, for his part, on the morning of Waterloo, famously dismissed Wellington as a mere “sepoy general”. Mr Roberts convincingly shows that this was to boost his marshall's morale and that the emperor had a shrewd idea that the duke was indeed his chief rival, and not just in war. The duke made it his business to sleep with at least two of the emperor's mistresses and, according to one of them, won on that

battlefield too.

The chief triumph of this book is its depiction of Wellington. He remains a great general, but is shown to have had feet of clay inside those famous boots. Mr Roberts sees Wellington's vanity and unattractive lack of generosity in sharing credit for his victories, but on the vexed question of “who won Waterloo?”—on which so much ink has been spilt recently—he is refreshingly sane. This is a splendid book, never less than interesting, sometimes careless (it is surprising to be told that the 1807 Danish campaign was designed “to weaken the French hold on that country”), but always trenchant. It redefines Wellington without diminishing his achievements and ends by reminding us that it was Napoleon who so forcefully articulated a wish that there should be “a European code of laws, a European judiciary...one people in Europe”. The ogre's dream is coming true.

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British politics

A marriage made in Downing Street

Sep 27th 2001
From The Economist print edition

The Rivals: The Intimate Story of a Political Marriage
By James Naughtie

Fourth Estate; 368 pages; £16.99

Buy it at Amazon.co.uk

WITHIN its self-imposed limits, this is an admirable book, as well written and well informed as you could want from a seasoned journalist and presenter of BBC radio's indispensable “Today” programme, a morning current-events round-up. But the two limits James Naughtie sets himself matter.

First, Mr Naughtie elects to examine British politics through a particular lens: the rivalrous relationship between Tony Blair and Gordon Brown, his chancellor of the exchequer and presumed successor. This is indeed the key personal relationship of the Blair administration. “We have seen nothing like it before,” says Mr Naughtie; the two men live “with an intimacy which has caused each of them intense anxiety and anger”; their partnership has the intensity of a “marriage”. And so disproportionately on. If you do not believe that Messrs Blair and Brown are the most psychologically fascinating pairing since Victoria and Albert, Bonnie and Clyde or Gabriel and Lucifer, you will not enjoy this book as you are intended to.

Second, Mr Naughtie confesses from the start that his is “a story of character and power”. In other words, the real-world political consequences of the Blair-Brown rivalry interest him less than the rivalry itself. The book therefore amounts to high-class gossip, well recounted but devoid, alas, of the revelations that have spiced previous books in this genre, such as Andrew Rawnsley's “Servants of the People” or Paul Routledge's biography of Mr Brown, which contained details of the secret home loan to Peter Mandelson, commonly described as the third person in the Blair-Brown marriage.

Admirers of Mr Naughtie may be more interested in his prophecy than his history-telling. His final, predictive chapter portrays a chancellor who even after New Labour's second election victory is “restless and ambitious”, blocked in by a prime minister who shows no sign of stepping aside. Mr Brown is often spoken of as the obvious successor, but most of the cabinet, Mr Naughtie writes, do not want him as an heir.

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About sponsorship

Anja Silja

Still making her mark

Sep 27th 2001
From The Economist print edition

The enduring dramatic talent and extraordinary voice of Anja Silja

Fully engaged

AT THE start of her career, in the late 1950s and early 1960s, Anja Silja seemed to defy the natural order of things where operatic voices are concerned. She ranged from the highest coloratura parts, such as the Queen of the Night in Mozart's "Die Zauberflöte" and Zerbinetta in Richard Strauss's "Ariadne auf Naxos", to the heaviest of dramatic roles, Wagner's Isolde and Brünnhilde. Richard Wagner's grandson, Wieland, was her mentor and lover, and she became one of the symbols of the "new Bayreuth", where his productions helped to change the whole practice of staging opera. Critics were entranced by her fresh approach to those roles—while predicting disaster for her career if she continued to use her voice so recklessly.

Now 40 years on, Ms Silja remains one of the most exciting and controversial figures in opera. She is currently at London's Royal Opera House in a favourite part of hers, the Kostelnicka in Leos Janacek's "Jenufa" (September 28th-October 19th). Earlier this year she had great success at Glyndebourne and in New York as the 300-year-old prima donna in the same composer's "Makropoulos Case".

Ms Silja was born in Berlin in 1940. Her childhood was spent in the home of her grandfather, a painter and amateur musician with whom she studied voice and piano from the age of five. He was, Ms Silja remembers, a very dominating personality; everyone in the family was frightened of him, except her. By the age of 12 she was giving concerts, and was not yet 16 when she made her stage debut as Rosina in Rossini's "Barber of Seville", at the State Theatre in the Lower Saxon town of Brunswick. "I had a very high voice, I could sing an octave above high C, like Yma Sumac," she says. "I've never been afraid of high notes, and although I've lost an octave at the top, it still helps me now."

Ms Silja's first Bayreuth performance was as Senta in "The Flying Dutchman", at the 1960 festival. The late William Mann, writing in *Opera* magazine, declared that if she were to sing the other Wagner soprano parts, "she would light those roles with a glorious new flame". That is precisely what happened, for between 1961 and 1967 she added all the major parts. Her performances as Elisabeth in "Tannhäuser" and Elsa in "Lohengrin" gained new dimensions from her charismatic acting and passionate, fearless vocalism.

Away from Bayreuth, Wieland Wagner directed Ms Silja in two roles with which she became especially associated, Richard Strauss's Salome and Alban Berg's Lulu. Her Salome—with a dance of the seven veils that revealed her clad in a black-sequinned bikini—caused outrage and rapture in equal measure, while she brought to Lulu a combination of innocence and depravity that would surely have pleased Frank Wedekind, author of the plays on which the opera is based.

Ms Silja's performances have been compared to those of Greta Garbo, a 1930s screen idol. This makes Ms Silja laugh, though she agrees that it must have something to do with her Scandinavian origins (her family is of Finnish extraction) and what she characterises as a mixture of sadness and a wish to convey a "secret emotion". One of Garbo's directors, George Cukor, wrote that she had a way of using "the uncensored thought that the actor flashes to the audience...She was rather cool, but seething underneath." The description applies equally well to Ms Silja. She says that singing alone does not interest her; she has never attempted Lieder, for instance. She is fully committed to the drama.

It is for this reason that she finds the operas of Janacek so satisfying. In "Jenufa", she has developed her portrayal of the Kostelnicka, a church sextoness who is driven to distraction when her stepdaughter gives

birth to an illegitimate child. “I have attempted to show her not as a harsh, monstrous person, not at all,” Ms Silja says. “But she's selfish, she thinks first of what it all means to her, and of the others afterwards. In this opera, as in ‘Makropulos', Janacek develops the music in the most wonderful way for the singer. Some of it is almost like a play, but then there come lyrical passages. It makes a huge difference to sing it in Czech, rather than in translation. Still, I'm very glad that I did sing ‘Makropulos' in German first, because it helped me to learn every aspect of the part, each bit of that complex woman.”

Like the heroine of “Makropulos”, Ms Silja has passed through many stages in her life. She lived with Wieland Wagner for several years until his unexpected death at just 49. At first, she wanted to give up performing, and for many years she did not sing Wagner. Later she took up with the conductor André Cluytens, who also died suddenly. In the 1970s, she married another conductor, Christoph von Dohnanyi, and they had three children. Although they are now divorced their life together was contented and they made many joint recordings and concert appearances.

These days Ms Silja tours the world, with no permanent home. Her engagement book is full for the next few years. Her commitments include a Schoenberg double-bill (“Erwartung” and “Pierrot Lunaire”) with Pierre Boulez; the role—new to her—of Judith in Bartok's “Bluebeard's Castle”; and productions of “Lulu”, “Elektra” and “Jenufa” around the world. Ms Silja says that, off-stage, she is quite a withdrawn, shy person. Anyone who has seen her vivid and emotionally charged performances may find this hard to believe. But she adds that it is this contrast between her public and private personas that has made her the artist that she is.

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About sponsorship

Art history

American in Paris

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From The Economist print edition

Painting American.
By Annie Cohen-Solal.
Knopf; 436 pages; $30

SUBTITLED “The Rise of American Artists: Paris 1867-New York 1948”, this lengthy, digressive and intermittently fascinating book is the work of a French writer, teacher and former cultural counsellor at the French embassy in New York.

A dedicated student of ideas and people in French high culture in the late 20th century, on her return to Paris Ms Cohen-Solal wrote a book on Jean-Paul Sartre, which has been translated into 16 languages. But she had unfinished business with American art. Why was it, she asked herself, that American painters had taken so long to be accepted in Europe? Was the idea of what she calls “painting American” a private aberration?

Fired up by this idea, she decided to go way, way back in her researches. In 1867 Paris played host to the world in a huge and miscellaneous Universal Exhibition of Art and Industry. In this exhibition the achievements of the can-do aesthetic of American industry were enormously admired. But the American art on view took a terrible beating, and was likened by one Parisian critic to “a giant bumpkin stumbling around a ballroom”.

In choosing to start her story with the humiliations of 1867, the author took on a very long haul. She burrowed in museums on both sides of the Atlantic. She studied the function of the art school. She unravelled the politics of art. She laid siege to collectors, and more than one veteran art dealer was glad to see her.

Along the way, her book took on a new character. Though still about the fortunes of “painting American”, it came to be more and more about “promoting American”. When writing about the founders, trustees, directors and staffs of American museums, she is consistently rewarding. With collectors, patrons, scholars, top-end dealers, and (to a lesser extent) the potential of the auction house, she has a lot to say and keeps the ball bouncing. If she doesn't always find the words to characterise the work of the American painters in Paris, that may be just as well.

By the beginning of the French Third Republic, as she tells it, there were 3,000 American artists in Paris. But this is not a context in which numbers have much meaning. Nor do lists of names convince, when there is no indication that Ms Cohen-Solal has actually seen their work. That George Healy, Daniel Ridgway Knight and Anna Elizabeth Klumpke were decent painters who lived in Paris is neither here nor there. “Did they bring something that was entirely their own?” is the question, and most often they didn't.

That they loved living in France is beyond question. The author tells us that some of those who had followed French painters to Pont-Aven in Brittany identified with it so strongly that even when back home in Massachusetts they still sported berets and clogs. And when Frederick Bridgman won a medal at the Salon and received the Legion of Honour, he is said to have had the ribbons in question sewn into his underclothes.

Ms Cohen-Solal is at her best when mining the private history of the art trade. She gives in full the letter in which Paul Durand-Ruel, the leading Parisian dealer of the day, spelled out for an inquirer the exact location of scores of important French paintings that had entered American collections by 1895.

She also gives a brisk and truthful account of the way in which, in 1939, Picasso's “Demoiselles

d'Avignon”—arguably the most famous painting of the 20th century—was acquired from Jacques Doucet, a collector and couturier for the Museum of Modern Art in New York.

What is lacking until page 327 of this book is a major painter who is now accepted as unmistakably and irreducibly American, both in his or her imaginative lineage and in the idiom that eventually resulted. In that context, Ms Cohen-Solal gives her vote in the end to Jackson Pollock, whose famous antics with a poured can of paint she traces back to the American-Indian bear-dance ritual that Pollock (then aged eight) had watched in Jacksonville, California.

She also places a last-minute side bet on Agnes Martin, the loved and admired doyenne of Taos, New Mexico. Here, too, she reaches back to American-Indian times. Martin's soft-spoken and unemphatic canvases remind the author of “Indian blankets, patiently woven by Pueblo women beside their sacred lake, the Great Blue Lake, thousands of years ago.”

Given the quality of both Pollock and Agnes Martin and their status as polar opposites, this makes a neat curtain call. But how many gifted men and women it leaves out!

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About sponsorship

War criminals

It's good to talk

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ONCE they are in its grasp, what should the world do with the perpetrators of unquestionable wickedness? The victors in the second world war faced this question early in 1945. Long before Hitler's suicide on April 30th 1945, his enemies knew that the German head of state was evil. But the allies were not agreed on the desirability of a trial, as Richard Overy demonstrates in his commentary on an interesting new collection of the interrogation documents prepared for the Nuremberg trial. Winston Churchill wanted summary execution for the leading Nazis. But a preference for legal process, by both the United States and the Soviet Union (influenced, as Mr Overy shows, by its show trials of the 1930s) won out.

Interrogations: The Nazi Elite in Allied Hands, 1945
By Richard Overy

Viking; 650 pages; $32.95. Allen Lane, The Penguin Press; £25

Buy it at
Amazon.com
Amazon.co.uk

Some of the charges were quite problematical, and Mr Overy rehearses the difficulties with the conspiracy charge. It was not clear how sane some of the defendants were, whether Rudolf Hess's amnesia was feigned or not, and whether those accused who were apparently more co-operative were not hiding something. Albert Speer, who presided over the slave-labour empire of the war economy, and whose reputation was later debunked by the investigations of Matthias Schmidt and Gitta Sereny, was treated more leniently than his less appealing deputy, Fritz Sauckel, who was sentenced to death.

Their subjects were difficult, and interrogators sometimes resorted to wooing them to get information. Hermann Goering was surprised, telling one of his interrogators: “Captain, you don't do this right. If we'd won...you'd be standing up...you'd have a black and white prisoner's suit, and there would be two SS men standing behind you, sticking you in the butt with bayonets.”

In fact, the documents in this book show that on the whole the Allies did it the right way. They left a vital precedent, which pointed towards recent international successes at The Hague, not only in the acceptance of rules of procedure and evidence satisfying diverse legal traditions, but in the trial and conviction of known war criminals. Against every prediction, the war-crimes tribunal is now trying Slobodan Milosevic of Serbia. Is it Utopian to think that a similar court might be a good place to try the surviving perpetrators of September 11th?

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About sponsorship

Marcos Perez Jimenez

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Marcos Perez Jimenez, an old-fashioned dictator, died on September 20th, aged 87

AP

WHEN Marcos Perez Jimenez became dictator of Venezuela in 1952 he was warmly welcomed into an exclusive circle of authoritarian rulers in Latin America. Juan Domingo Peron of Argentina was probably the best known, if only because of the political flair of his actress wife Evita. But Peru, the Dominican Republic and Nicaragua were also under the thumb of leaders united by their distaste for democracy, while ambitious soldiers in Brazil, Colombia, Uruguay and Chile were biding their time until they too could seize power.

One concern of Mr Perez was how best to impress fellow dictators and other distinguished visitors to his country. The Spanish, in their 300 years of rule, had not provided the country with much in the way of architectural gems. Mr Perez did what show-off rulers have done since antiquity. He set out to give his capital, Caracas, a look of wealth and power. Today, its skyscrapers look a touch dated and the marble-lined motorway tunnels seem merely vulgar. But in the 1950s the town was the smartest sight in South America. On a mountain overlooking Caracas Mr Perez built the Humboldt, then said to be the smartest hotel in the world. Among other fantasies, it had a ballroom with a rotating floor and an ice-skating rink, a rarity in the tropics. After the hotel opened in 1957 it was patronised by the famous, including Fidel Castro when he discarded his battledress and took over Cuba.

There was no shortage of money for these extravagances. Venezuela was for many years the world's largest exporter of oil. Its reserves, though now depleted, are still the largest in the western hemisphere. The United States, Venezuela's best customer for oil, has greatly valued this reliable source just across the way. The Americans overlooked the brutalities of the Perez regime, the imprisonment, torture and murder of opposition figures, the censorship of the press and the corruption, which allowed the dictator to accumulate a fortune of $250m. President Eisenhower gave him a medal, the Legion of Merit. Mr Perez—“P.J.” as American diplomats called him—must have felt secure with such a powerful friend. But the political instability that brought him to power eventually did for him too.

Dominoes and pretty girls

The idea of democratic government was slow to take hold in Venezuela. Not until 1947, two years after the second world war and the defeat of fascism, did the country elect a president on a free vote. He lasted eight months, replaced by a junta of three men, one of them Mr Perez. He was a professional soldier, having joined the army at 17, gradually rising to the rank of lieutenant-colonel, partly through luck, partly because of his mastery of army bureaucracy. The junta leader was murdered in 1950, some said on the orders of Mr Perez. From then on he was the power in Venezuela, consolidated in 1952 when he became president in an election assumed to have been fixed.

The Venezuelans were told that their new leader was a thoughtful man who liked to relax over a game of dominoes. But stories circulated that what he really liked was to organise races at beach picnics between pretty girls in swimsuits. Being of tubby build Mr Perez declined to take part in the races himself but would follow the contestants on a motor scooter. There are some Venezuelans who like to recall a kinder, if ridiculous, Perez Jimenez, rather than the tyrant. Unlike Caracas today, they say, it was safe to walk the streets at night because of Mr Perez's system of “controlled liberty”. But then there are Russians nostalgic for Stalin.

Mr Perez lasted until 1958 when he was toppled by another military junta, but one that honoured its

promise to restore democracy. In Venezuela, as in most of Latin America, dictatorship has gone out of fashion. Democracy has survived at least two attempted coups and has had lapses into corruption, though few to match Mr Perez's. In his rush to get away to exile in the United States with his wife and children, he left behind a suitcase containing details of property and other assets illegally accumulated in his years in power.

The Americans were reluctant to send him back to Venezuela to face trial for corruption, but after five years of court battles he was surrendered, the first time a former ruler of a foreign country had been extradited from the United States. In 1963 a Venezuelan court sentenced Mr Perez to four years in jail. On his release he moved to Spain, but Venezuelan politics could not entirely get rid of him: his former party, the Civic Crusade, could command 10% of the vote in parliamentary elections. Mr Perez considered standing for president while in exile, but the government barred him.

However, in recent years Venezuela offered Mr Perez a pardon for his misdeeds, which he rejected saying he had done nothing to be pardoned for. The United Nations has made Venezuela's Central University, a building of fascist-style immensity, a “world heritage site”. The Humboldt hotel, which lost its lustre after Mr Perez's departure, is being restored. Dictators, say his apologists, are sadly tempted into corruption, but they claim that Perez Jimenez was a man of vision who left fine monuments. By the time of his death the “iron man of Venezuela” was, it seems, being transformed into an elder statesman.

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Overview

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The first survey of **America's** consumer sentiment since the terrorist attacks on September 11th pointed to worsening economic times ahead. The Conference Board's confidence index fell from 114.0 in August to 97.6 in September, its lowest since 1996. The index's fall was its sharpest one-month decline since October 1990, during the Gulf war, when it stood at 62.6. Few economists any longer doubt that America is heading into a recession, however much government officials may protest otherwise.

Europe's consumers seemed to share the American public's pessimism. **Dutch** consumer confidence slumped in September, as measured by survey responses taken just after the terrorist attacks. Elsewhere in Europe confidence also waned. Industrial production in the euro zone dropped by 1.1% in the year to July. In **Italy**, retail sales declined 1.5% in the 12 months to July. The rate of growth in **German** wages slowed to 1.4% in the year to July.

Some surprisingly good news came from **Britain**, where GDP growth for the second quarter was revised upwards from an annualised 2.1% to 2.3%. The revised figure reflects faster growth in the services and construction industries.

Stockmarkets in America and Europe remained highly nervous. On September 21st, they hit multiple-year lows. The Dow Jones Industrial Average fell by 14.3% in the five days to September 21st, to record its biggest one-week loss since 1933. This left it nearly 30% below its peak in January 2000. Several European stockmarkets plunged by even more. France's CAC-40 closed on September 21st down 47% from its peak in September 2000; Germany's DAX was 53% down from its all-time high in March 2000.

Since September 21st, **shares** have rebounded a little worldwide, especially on September 24th, but both Wall Street and Tokyo still ended lower over the week to September 26th. Europe's stockmarkets, in contrast, made small gains, with the CAC-40 rising by 2.2%, and the DAX up by 1.3%.

The drop in **oil prices** accelerated, cheering oil importers. On September 24th, the price of West Texas Intermediate crude fell by 15%, its biggest one-day decline since the end of the Gulf war in 1991. Oil prices fell again on September 26th, dropping briefly below $21 a barrel in intra-day trading.

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Output, demand and jobs

Sep 27th 2001
From The Economist print edition

% change at annual rate

	GDP		The Economist poll GDP forecasts		Industrial production	Retail sales (volume)	Unemployment % rate	
	1 qtr	1 year	2001	2002	1 year	1 year	latest	year ago
Australia	+ 3.6	+ 1.4 Q2	+ 2.5	+ 4.0	– 1.4 Q1*	+ 0.7 Q2	6.8 Aug	6.1
Austria	+ 1.6	+ 2.2 Q1	+ 1.7	+ 2.1	+ 8.0 Jun	– 3.3 May	3.9 Aug	3.6
Belgium	– 2.4	+ 1.7 Q2	+ 1.9	+ 2.4	+ 5.2 Jul*	+ 5.3 Jun	11.6 Aug*	11.9
Britain	+ 1.7	+ 2.3 Q2	+ 2.1	+ 2.6	– 3.2 Jul	+ 6.3 Aug	5.0 Jul†	5.3
Canada	+ 0.4	+ 2.1 Q2	+ 2.1	+ 2.8	– 2.4 Jun	+ 3.5 Jun	7.2 Aug	7.1
Denmark	+ 2.4	+ 1.3 Q2	+ 1.3	+ 2.1	+ 4.4 Jun	+ 3.0 Jun	5.1 Aug	5.4
France	+ 1.0	+ 2.3 Q2	+ 2.2	+ 2.3	+ 2.3 Jun	– 1.2 Jul	8.9 Jul	9.5
Germany	nil	+ 0.6 Q2	+ 1.1	+ 1.9	– 1.5 Jul	+ 0.9 Jul	9.3 Aug	9.4
Italy	– 0.5	+ 2.0 Q2	+ 1.9	+ 2.2	+ 1.7 Jul	– 1.5 Jul	9.5 Apr	10.7
Japan	– 3.2	– 0.7 Q2	– 0.4	+ 0.5	– 8.5 Jul	– 2.1 Jun	5.0 Jul	4.7
Netherlands	+ 1.6	+ 1.5 Q2	+ 1.7	+ 2.5	+ 0.7 Jun	+ 1.8 May	2.0 Aug§	2.5
Spain	+ 1.9	+ 2.9 Q2	+ 2.7	+ 2.8	– 1.6 Jul	na	13.0 Aug	13.9
Sweden	+ 1.3	+ 1.4 Q2	+ 2.0	+ 2.6	+ 2.6 Jun	+ 2.6 Jul	4.3 Aug*	5.1
Switzerland	+ 1.7	+ 2.0 Q2	+ 1.6	+ 1.9	+ 4.2 Q2*	+ 3.3 Jul	1.7 Aug*	1.8
United States	+ 0.2	+ 1.2 Q2	+ 1.6	+ 2.6	– 4.8 Aug	+ 3.8 Jul	4.9 Aug	4.1
Euro area	+ 0.2	+ 1.7 Q2	+ 1.8	+ 2.2	– 1.1 Jul	+ 2.1 Jun	8.3 Jul	8.8
MORE COUNTRIES	Data for the countries below are not provided in printed editions of *The Economist*							
Finland	– 6.7	+ 0.4 Q2	na	na	– 5.4 Jul	+ 2.2 May	7.8 Aug*	8.3
Greece	+ 2.8	+ 4.9 Q2	na	na	+ 0.3 May*	+ 8.1 May	na	na
Iceland	na	+ 3.62000	na	na	+ 2.5 2000	na	1.2 Jul	1.3
Ireland	na	+12.1 Q4	na	na	– 2.3 Jul*	+ 1.1 Jun	3.7 Aug	3.9
Luxembourg	na	+ 8.52000	na	na	+ 4.3 Jun*	+ 8.2 Jun	2.4 Jul	2.6
New Zealand	+ 0.9	+ 0.4 Q1	na	na	+ 0.9 Q1*	+ 7.2 Q2	5.2 Q2	6.1
Norway	+ 0.5	+ 1.4 Q2	na	na	– 8.0 Jul*	+ 0.4 Jul	3.6 Q2	3.3
Portugal	– 0.3	+ 2.2 Q1	na	na	+ 0.6 Jul*	+ 5.5 Jun	4.2 Q1	4.4

*Not seasonally adjusted. † May-Jul; claimant count rate 3.1% in Aug. §Jun-Aug.

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Prices and wages

Sep 27th 2001
From The Economist print edition

% change at annual rate

	Consumer prices*			The Economist poll consumer prices forecast		Producer prices*			Wages/earnings		
	1 year		year ago	2001	2002	1 year		year ago	1 year		year ago
Australia	+ 6.0	Q2	+ 3.2	+ 4.0	+ 2.4	+ 5.6	Q2	+ 7.4	+ 3.7	Q2	+ 3.9
Austria	+ 2.5	Aug	+ 2.7	+ 2.5	+ 1.8	+ 1.7	Aug	+ 4.3	+ 2.8	Aug	+ 1.9
Belgium	+ 2.7	Aug	+ 2.9	+ 2.5	+ 1.9	+ 4.0	Jul	+ 8.9	+ 2.6	Q2	+ 2.2
Britain	+ 2.1	Aug	+ 3.0	+ 2.1	+ 2.3	+ 0.3	Aug	+ 2.3	+ 4.6	Jul	+ 3.9
Canada	+ 2.8	Aug	+ 2.5	+ 2.8	+ 2.1	+ 0.9	Jul	+ 4.2	+ 1.7	Jul	+ 1.1
Denmark	+ 2.5	Aug	+ 2.4	+ 2.4	+ 2.0	+ 1.5	Aug	+ 6.4	+ 4.7	Q2	+ 3.3
France	+ 1.9	Aug	+ 1.8	+ 1.8	+ 1.5	+ 2.3	Jun	+ 6.0	+ 4.3	Q1	+ 5.2
Germany	+ 2.1	Sep	+ 2.5	+ 2.6	+ 1.5	+ 1.5	Aug	+ 5.6	+ 1.4	Jul*	+ 2.0
Italy	+ 2.8	Aug	+ 2.6	+ 2.7	+ 2.0	+ 1.4	Jul	+ 6.7	+ 2.5	Jul*	+ 2.0
Japan	− 0.8	Jul	− 0.5	− 0.5	− 0.4	+ 0.1	Aug	+ 0.2	+ 1.4	Jul*	+ 1.2
Netherlands	+ 4.7	Aug	+ 2.5	+ 4.6	+ 2.5	+ 2.4	Jul	+ 8.0	+ 4.4	Jul	+ 3.2
Spain	+ 3.7	Aug	+ 3.6	+ 3.7	+ 2.8	+ 2.0	Jul	+ 5.5	+ 3.4	Q1†	na
Sweden	+ 3.1	Aug	+ 1.3	+ 2.3	+ 1.8	+ 1.5	Aug	+ 3.7	+ 2.3	Jun*	+ 4.9
Switzerland	+ 1.1	Aug	+ 1.1	+ 1.3	+ 1.2	− 0.2	Aug	+ 2.4	+ 1.3	2000	+ 0.3
United States	+ 2.7	Aug	+ 3.4	+ 3.2	+ 2.2	+ 2.1	Aug	+ 3.4	+ 4.2	Aug	+ 3.8
Euro area	+ 2.7	Aug	+ 2.3	+ 2.7	+ 1.8	+ 2.3	Jul	+ 5.6	+ 2.6	Q1	+ 2.4
MORE COUNTRIES	Data for the countries below are not provided in printed editions of *The Economist*										
Finland	+ 2.4	Aug	+ 3.8	na	na	− 0.1	Aug	+ 7.6	+ 4.8	Q2*	+ 4.6
Greece	+ 3.8	Aug	+ 3.0	na	na	+ 4.5	Jul	+ 7.7	na		na
Iceland	+ 8.4	Sep	+ 4.0	na	na	+ 6.8	Sep	+ 3.4	+ 8.8	Aug	+ 7.9
Ireland	+ 4.6	Aug	+ 6.2	na	na	+ 2.6	Aug	+ 6.5	+ 8.1	Q1*	+ 6.1
Luxembourg	+ 2.8	Aug	+ 3.1	na	na	+ 0.4	Jul	+ 6.7	+ 7.8	Jun*	+ 5.3
New Zealand	+ 3.2	Q2	+ 2.0	na	na	+ 8.1	Q2	+ 5.9	+ 1.8	Q2	+ 1.7
Norway	+ 2.7	Aug	+ 3.5	na	na	− 4.3	Aug	+ 6.4	+ 4.4	Q2*	+ 3.9
Portugal	+ 4.0	Aug	+ 3.5	na	na	+ 1.3	Jul	+17.4	+ 2.4	Apr*	na

*Not seasonally adjusted. †New series.

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Consumption of soft drinks

Sep 27th 2001
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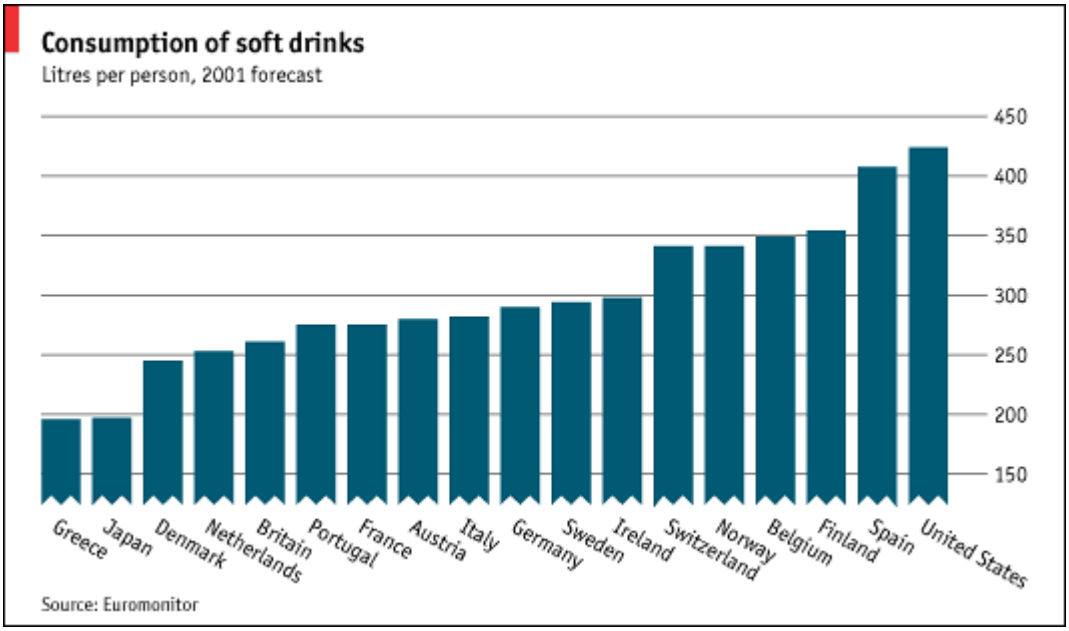

Americans consume on average over a litre of soft drinks a day, more than twice as much as Greeks. It is the way of the future. Soft drinks are the fastest growing part of the world drinks market. Younger people increasingly prefer them to alcohol, especially beer and spirits. Within the soft-drinks market, fruit juices and bottled water are winning favour over carbonated drinks.

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Money and interest rates

Sep 27th 2001
From The Economist print edition

	Money supply* % change on year ago			Interest rates % p.a. (Sep 26th 2001)					
				3-mth money market		2-year	10-year gov't bonds		corporate
	narrow	broad		latest	year ago	gov't bonds	latest	year ago	bonds
Australia	+17.7	+ 6.6	Jul	4.43	6.64	4.21	5.60	6.23	5.51
Britain	+ 7.2	+ 7.2	Aug	4.44	6.13	4.54	4.87	5.32	6.40
Canada	+ 7.6	+ 3.6	Aug	3.06	5.57	3.35	5.32	5.74	7.10
Denmark	+ 5.5	+ 1.0	Jul	4.24	6.35	4.04	5.01	5.57	7.01
Japan	+ 9.7	+ 3.4	Aug	0.01	0.31	0.06	1.39	1.86	1.47
Sweden	+ 6.6	+ 2.5	Aug	3.71	3.96	4.05	5.27	5.23	5.27
Switzerland	+ 0.1	+ 2.6	Aug	2.25	3.45	4.65	3.22	3.93	4.00
United States	+ 4.0	+10.9	Aug	2.45	6.47	2.81	4.64	5.82	7.19
Euro area†	+ 3.3	+ 6.4	Jul	3.65	5.00	3.53	4.75	5.21	5.82

*Narrow: M1 except Britain and Sweden M0, broad: M2 or M3 except Britain M4. †Germany for bonds. Benchmarks: US 30-year 5.57%, Japan No.234 1.43%. Central bank rates: US fed funds 3.00%, ECB refinancing 3.75%, BOJ overnight call 0.002%, BOE repo 4.75%. Sources: Commerzbank, Danske Bank, J.P. Morgan Chase, Royal Bank of Canada, OM Fixed Income Exchange, Warburg Dillon Read, DRI-WEFA, Westpac, Thomson Financial Datastream. Rates cannot be construed as banks' offers.

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The Economist commodity price index

Sep 27th 2001
From The Economist print edition

1995=100

	Sep 18th	Sep 25th*	% change on one month	% change on one year
Dollar index				
All items	66.7	65.0	– 5.0	–10.7
Food	68.5	67.1	– 2.4	– 3.3
Industrials				
All	64.2	62.1	– 8.4	–19.7
Nfa†	62.9	60.2	–10.3	–11.4
Metals	65.2	63.6	– 6.9	–25.2
Sterling index				
All items	71.9	69.7	– 6.3	–11.5
Euro index				
All items	95.1	92.5	– 6.4	–14.9
Yen index				
All items	83.3	81.2	– 7.6	– 2.5
Gold				
$ per oz	287.50	289.45	+ 6.3	+ 5.4
West Texas Intermediate				
$ per barrel	27.74	21.82	–19.8	–31.2

* Provisional. † Non-food agriculturals.

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Stockmarkets

Sep 27th 2001
From The Economist print edition

Market indices

	Sep 26th	2001 high	2001 low	% change on one week	% change on record high	% change on Dec 31st 2000 in local currency	% change on Dec 31st 2000 in $ terms
Australia (All Ordinaries)	2,932.1	3,425.2	2,867.4	– 1.4	–14.4	– 7.1	–18.1
Austria (ATX)	1,074.8	1,245.8	1,052.2	– 3.6	–38.1	+ 0.1	– 1.8
Belgium (Bel 20)	2,493.7	3,030.4	2,322.6	+ 0.4	–32.3	–17.6	–19.1
Britain (FTSE 100)	4,696.1	6,334.5	4,433.7	– 0.5	–32.2	–24.5	–25.5
Canada (Toronto Composite)	6,654.8	9,348.4	6,513.1	– 0.6	–41.6	–25.5	–28.8
Denmark (KBX)	205.6	294.3	197.8	– 3.5	–31.9	–22.3	–23.5
France (SBF 250)	2,544.2	3,820.2	2,335.3	+ 2.0	–42.1	–32.5	–33.8
(CAC 40)	3,975.5	5,998.5	3,652.9	+ 2.2	–42.6	–32.9	–34.2
Germany (Xetra DAX)	4,095.3	6,795.1	3,787.2	+ 1.3	–49.2	–36.3	–37.5
Italy (BCI)	1,205.1	1,948.4	1,082.9	– 0.5	–44.8	–37.1	–38.3
Japan (Nikkei 225)	9,641.7	14,529.4	9,504.4	– 3.0	–75.2	–30.1	–32.2
(Topix)	998.3	1,441.0	863.4	– 3.8	–65.4	–22.2	–24.7
Netherlands (AEX)	434.5	642.3	396.2	+ 0.5	–38.1	–31.8	–33.1
Spain (Madrid SE)	698.5	963.9	648.6	+ 1.3	–39.1	–20.7	–22.2
Sweden (Affarsvarlden Gen)	185.1	293.1	177.5	– 0.1	–53.7	–33.3	–41.5
Switzerland (Swiss Market)	5,725.4	8,135.4	5,110.2	+ 1.3	–31.9	–29.6	–28.9
United States (DJIA)	8,567.4	11,337.9	8,235.8	– 2.2	–26.9	–20.6	–20.6
(S&P 500)	1,006.3	1,373.7	965.8	– 0.9	–34.1	–23.8	–23.8
(Nasdaq Comp)	1,464.0	2,859.2	1,423.2	– 4.2	–71.0	–40.7	–40.7
Europe (FTSE Eurotop 300)*	1,078.1	1,545.5	998.9	– 3.1	–36.8	–29.7	–31.0
Euro area (FTSE Ebloc 100)*	922.2	1,404.1	843.6	+ 1.5	–40.5	–33.8	–35.0
World (MSCI)†	898.6	1,249.2	856.6	– 1.0	–38.0	na	–26.4
World bond market (Salomon)‡	456.7	458.1	420.6	+ 0.0	– 0.7	na	+ 2.8

*In euro terms. †Morgan Stanley Capital International index includes individual markets listed above plus eight others, in dollar terms.
‡Salomon Smith Barney World Government Bond Index, total return, in dollar terms.

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Trade, exchange rates and budgets

Sep 27th 2001
From The Economist print edition

	Trade balance*, $bn latest 12 months	Current account $bn latest 12 mths	Current account The Economist poll % of GDP, forecast 2001	Current account The Economist poll % of GDP, forecast 2002	Exchange rate trade-weighted† Sep 26th	Exchange rate trade-weighted† year ago	Currency units per $ Sep 26th	Currency units per $ year ago	Currency units per £	Currency units per euro	Currency units per ¥100	Budget balance % of GDP 2001‡
Australia	+ 0.7 Jul	− 9.9 Q2	− 2.8	− 3.1	67.3	73.8	2.04	1.82	3.01	1.88	1.73	0.1
Austria	− 5.4 May	− 4.7 Jul	− 2.4	− 2.3	100.4	99.2	14.9	15.6	22.0	13.8	12.7	-0.6
Belgium	+ 10.6 Jul	+ 11.2 Mar	+ 4.2	+ 4.5	99.3	97.8	43.8	45.8	64.6	40.3	37.2	0.7
Britain	− 45.9 Jul	− 19.2 Q2	− 1.7	− 2.1	106.1	107.4	0.68	0.68	–	0.62	0.58	1.2
Canada	+ 47.4 Jul	+ 25.5 Q2	+ 3.1	+ 2.3	76.1	79.8	1.57	1.49	2.32	1.45	1.33	2.6
Denmark	+ 6.8 Jul	+ 4.6 Jul	+ 1.4	+ 1.4	103.4	99.7	8.07	8.47	11.9	7.44	6.85	2.9
France	+ 0.2 Jul	+ 17.4 Jul	+ 1.5	+ 1.6	102.0	100.3	7.12	7.44	10.5	6.56	6.04	-0.5
Germany	+ 59.2 Jul	− 21.3 Jul	− 1.0	− 0.9	99.0	96.8	2.12	2.22	3.13	1.96	1.80	-1.7
Italy	+ 3.6 Jun	− 4.9 May	− 0.3	− 0.2	72.8	71.6	2,102	2,197	3,100	1,936	1,783	-1.3
Japan	+ 84.3 Jul	+ 92.5 Jul	+ 2.1	+ 2.0	141.6	157.1	118	107	174	109	–	-6.3
Netherlands	+ 18.6 Jul	+ 13.7 Q2	+ 3.9	+ 3.9	98.3	96.5	2.39	2.50	3.53	2.20	2.03	1.3
Spain	− 38.3 Jul	− 16.6 Jun	− 2.8	− 2.3	74.4	73.3	181	189	266	166	153	nil
Sweden	+ 12.1 Aug	+ 5.2 Jul	+ 2.1	+ 2.3	70.8	81.0	10.75	9.66	15.9	9.90	9.12	3.6
Switzerland	+ 0.5 Aug	+ 27.0 Q2	+10.9	+10.7	112.1	106.3	1.60	1.73	2.37	1.48	1.36	na
United States	−450.6 Jul	−449.9 Q2	− 4.1	− 4.0	116.6	113.4	–	–	1.47	0.92	0.85	2.1
Euro area	+ 2.5 Jun	− 29.4 Jul	− 0.2	− 0.1	79.7	76.6	1.09	1.13	1.60	–	0.92	-0.6
MORE COUNTRIES	Data for the countries below are not provided in printed editions of *The Economist*											
Finland	+ 13.8 Jul	+ 9.1 Jul	na	na	79.3	76.2	6.69	6.75	9.87	6.16	5.68	5.3
Greece	− 7.4 Jun	− 7.7 Jan	na	na	57.6	57.0	384	385	566	353	325	nil
Iceland	− 0.3 Jul	− 0.9 Q1	na	na	na	na	100	82.8	147	91.8	84.6	2.4
Ireland	+ 29.1 Jun	− 1.3 Q1	na	na	87.9	85.5	0.89	0.89	1.31	0.82	0.75	4.5
Luxembourg	− 2.9 Jun	+ 1.2 Q1	na	na	99.3	97.8	45.4	45.8	67.0	41.8	38.5	3.6
New Zealand	nil Jul	− 2.3 Q1	na	na	76.4	75.0	2.31	2.41	3.41	2.13	1.96	1.0
Norway	+ 27.6 Aug	+ 26.6 Jul	na	na	96.5	92.8	8.94	9.12	13.2	8.23	7.58	15.3
Portugal	− 13.6 Jun	− 9.4 Jul	na	na	89.7	88.3	226	228	333	208	191	-1.2

*Merchandise. Australia, Britain, France, Canada, Japan and United States imports fob, exports fob. All others cif/fob. †1990=100, Bank of England. ‡OECD estimate.

Text refers only to the first 16 countries listed

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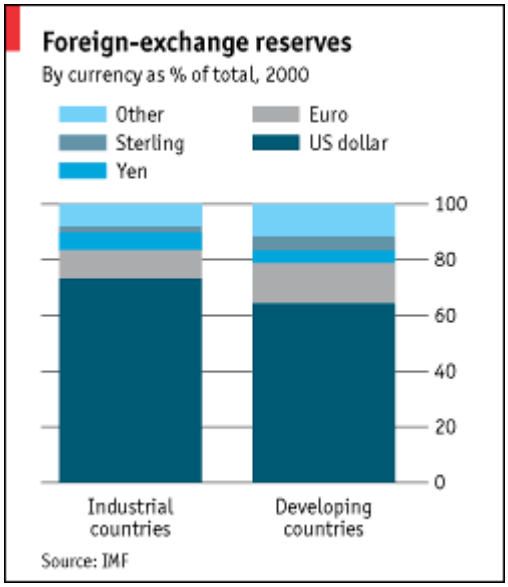
Foreign-exchange reserves

Sep 27th 2001
From The Economist print edition

The dollar made up 68% of global foreign-exchange reserves in 2000, up from 51% in 1991. All the rise was in rich-country holdings, where dollars rose from 44% to 73% of the total.



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Overview

Sep 27th 2001
From The Economist print edition

Poland's economy is stuttering. Polish GDP grew by a meagre 0.9% in the year to the second quarter, the slowest in over a decade. Construction, once one of the country's strongest industries, contracted last month by a record 14%.

Russia, however, continues to enjoy strong growth: its GDP rose by 5.1% in the year to the second quarter. Industrial production also grew by 5.1% in the year to August. Long-suffering Russian consumers seem at last to be reaping much of the benefit, as production of food and beverages expanded by 13.0% in the same period.

East Asia's economies continue to be squeezed by the prospects of an American recession. In the 12 months to August, industrial production fell by 21.4% in **Singapore** and by 8.2% in **Taiwan**.

Stockmarkets in most emerging economies remain edgy. Most fell over the week to September 26th: Cairo, Moscow and Buenos Aires all tumbled by more than 8% each.

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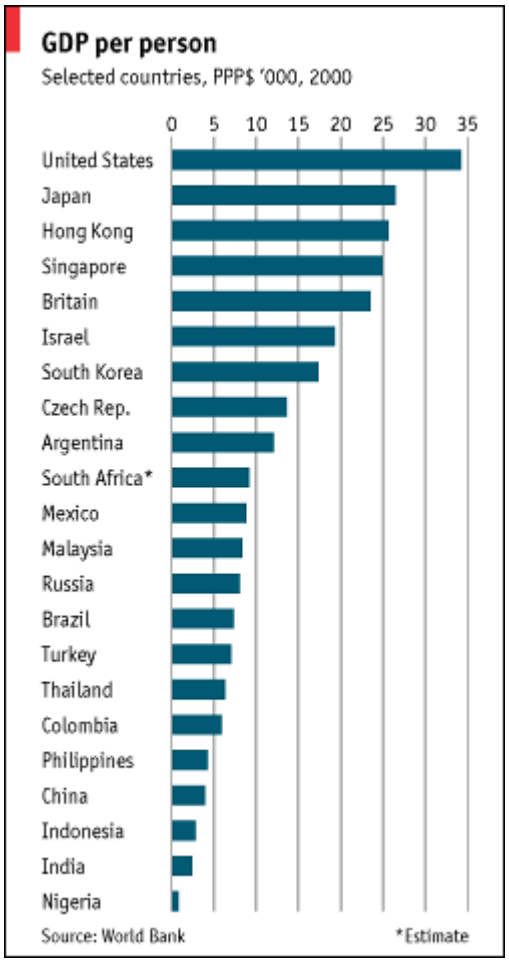
GDP per person

Sep 27th 2001
From The Economist print edition

Purchasing-power-parity exchange rates even out international differences in the prices of goods and services, making national-income comparisons a better measure of consumers' actual buying power. Differences in living standards also narrow. Even so, huge gaps remain.



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Economy

Sep 27th 2001
From The Economist print edition

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	% change on year earlier						Latest 12 months, $bn				Foreign reserves* $bn, latest	
	GDP		Industrial production		Consumer prices		Trade balance		Current account			
China	+ 7.8	Q2	+ 8.1	Aug	+ 1.0	Aug	+18.8	Aug	+20.5	2000	183.9	Jun
Hong Kong	+ 0.5	Q2	– 0.1	Q1	– 1.1	Aug	–12.0	Aug	+ 8.8	Q1	113.7	Aug
India	+ 3.8	Q1	+ 2.6	Jul	+ 4.0	Jul	– 5.5	Jul	– 2.3	Q1	42.5	Aug
Indonesia	+ 3.5	Q2	+ 7.5	Q1	+12.2	Aug	+24.5	Jul	+ 6.3	Q1	28.2	Jul
Malaysia	+ 0.5	Q2	– 5.9	Jul	+ 1.3	Aug	+15.4	Jul	+ 7.4	Q1	26.9	Jul
Philippines	+ 3.3	Q2	+11.2	Jun	+ 6.3	Aug	+ 4.5	Jul	+ 7.8	May	12.6	Jun
Singapore	– 0.9	Q2	–21.4	Aug	+ 0.7	Aug	+ 4.2	Aug	+22.6	Q2	74.4	Jun
South Korea	+ 2.7	Q2	– 5.9	Jul	+ 4.7	Aug	+13.1	Aug	+13.3	Jul	97.0	Jul
Taiwan	– 2.4	Q2	– 8.2	Aug	+ 0.4	Aug	+13.8	Aug	+14.1	Q2	110.1	Jul
Thailand	+ 1.9	Q2	+ 2.1	Jul	+ 1.4	Aug	+ 2.5	Jul	+ 6.1	Jul	31.2	Jul
Argentina	– 0.5	Q2	– 5.3	Aug	– 1.2	Aug	+ 2.6	Jul	– 9.0	Q1	16.7	Jul
Brazil	+ 0.8	Q2	+ 0.8	Jul	+ 7.3	Aug	– 1.1	Aug	–27.5	Jul	35.5	Jul
Chile	+ 3.4	Q2	+ 0.3	Jul	+ 3.8	Aug	+ 1.5	Aug	– 1.6	Q2	14.5	Jul
Colombia	+ 1.6	Q2	+ 0.5	Jul	+ 8.0	Aug	+ 0.9	Jul	– 0.7	Q1	9.5	Jul
Mexico	nil	Q2	– 3.3	Jul	+ 5.9	Aug	– 9.5	Aug	–17.5	Q2	40.8	Jul
Peru	– 0.8	Jul	– 3.3	Jul	+ 1.4	Aug	– 0.2	Jul	– 1.4	Q2	8.4	Jun
Venezuela	+ 2.9	Q2	na		+12.9	Aug	+15.6	Q2‡	+11.1	Q2	10.6	Jul
Egypt	+ 6.5	2000†	+ 9.4	2000†	+ 2.2	Jul	– 9.9	Q1	– 0.2	Q1	12.9	May
Israel	+ 1.4	Q2	– 5.8	Jul	+ 1.7	Aug	– 7.3	Aug	– 1.1	Q1	24.2	Aug
South Africa	+ 2.5	Q2	+ 1.0	Jul	+ 4.6	Aug	+ 4.5	Jul	+ 0.1	Q1	6.1	Jul
Turkey	– 9.3	Q2	–11.2	Jul	+57.5	Aug	–20.9	Jun	– 3.7	Jun	17.2	Jul
Czech Republic	+ 3.9	Q2	+ 9.3	Jul	+ 5.5	Aug	– 3.5	Aug	– 2.7	Q2	13.4	Aug
Hungary	+ 4.0	Q2	– 0.8	Jul	+ 8.7	Aug	– 2.2	Jul	– 1.5	Jul	12.0	Aug
Poland	+ 0.9	Q2	+ 0.7	Aug	+ 5.1	Aug	– 9.9	Jul	– 6.8	Jul	27.0	Jul
Russia	+ 5.1	Q2	+ 5.1	Aug	+20.9	Aug	+58.4	Jul	+45.9	Q1	33.7	Aug
MORE COUNTRIES	Data for the countries below are not provided in printed editions of *The Economist*											
Pakistan	+ 3.3	2001†	+ 9.1	May	+ 2.5	Jul	– 1.5	Jul	– 1.1	2001†	1.3	May
Saudi Arabia	+ 4.5	2000§	na		– 0.5	Jun	+50.9	2000	+15.6	2000	17.0	Jul

*Excluding gold, except Singapore; IMF definition. †Year ending June. ‡New series § Economist Intelligence Unit estimate.

Text refers only to the first 25 countries listed

Sources: National statistics offices, central banks and stock exchanges; Thomson Financial Datastream; Economist Intelligence Unit; Reuters; Warburg Dillon Read; J.P Morgan Chase; Hong Kong Monetary Authority; Centre for Monitoring Indian Economy; FIEL; EFG-Hermes; Bank Leumi Le-Israel; Standard Bank Group; Garanti Bank; Deutsche Bank; Russian Economic Trends.

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Financial markets

Sep 27th 2001
From The Economist print edition

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	Currency units			Interest rates	Stockmarkets	% change on		
	per $		per £	short-term	Sep 26th		Dec 31st 2000	
	Sep 26th	year ago	Sep 26th	% p.a.		one week	in local currency	in $ terms
China	8.28	8.28	12.2	na	1,848.3	-3.0	-15.7	-15.7
Hong Kong	7.80	7.80	11.5	2.49	9,371.8	-2.0	-37.9	-37.9
India	47.9	46.1	70.6	7.21	2,667.3	-4.9	-32.8	-34.5
Indonesia	9,635	8,845	14,211	17.86	401.0	-5.1	-3.7	-3.3
Malaysia	3.80	3.80	5.60	3.30	602.5	-4.9	-11.3	-11.3
Philippines	51.4	46.3	75.7	14.25	1,144.3	-3.6	-23.4	-25.4
Singapore	1.77	1.74	2.61	2.02	1,277.7	-4.8	-33.7	-34.9
South Korea	1,300	1,114	1,917	4.42	472.9	-2.9	-6.3	-8.8
Taiwan	34.6	31.2	51.0	3.10	3,625.5	-4.1	-23.6	-26.8
Thailand	44.3	42.2	65.4	3.00	275.7	-4.0	+2.4	+0.2
Argentina	1.00	1.00	1.47	12.80	244.7	-8.9	-41.3	-41.4
Brazil	2.73	1.85	4.03	19.06	10,005.9	-5.2	-35.9	-54.2
Chile	695	567	1,025	0.43*	5,123.8	-5.0	+5.2	-13.1
Colombia	2,329	2,215	3,435	11.96	925.9	-3.0	na	na
Mexico	9.53	9.42	14.1	9.67	5,324.8	+0.5	-5.8	-5.0
Peru	3.48	3.50	5.1	5.65	1,219.8	-3.6	+0.9	+2.2
Venezuela	743	690	1,095	15.43	6,973.4	-1.1	+2.6	-3.3
Egypt	4.25	3.58	6.27	8.80	5,701.9	-8.1	-25.6	-31.9
Israel	4.36	4.03	6.43	4.47	358.6	-2.5	-27.5	-32.7
South Africa	8.87	7.24	13.1	9.02	7,941.4	+0.9	-4.6	-18.6
Turkey	1,552,000	664,505	2,289,045	56.00	7,477.4	-5.3	-20.8	-65.8
Czech Republic	36.9	40.2	54.4	5.33	337.0	+1.8	-29.6	-28.2
Hungary	279	299	412	10.92	6,074.4	+2.5	-22.6	-21.8
Poland	4.20	4.55	6.20	14.27	11,816.1	-3.6	-33.8	-34.9
Russia	29.4	27.8	43.4	25.00	176.8	-11.3	+26.6	+23.4
EMF (MSCI)‡	1.00	1.00	1.47	na	247.5	-4.7	na	-25.9
EMBI+§	1.00	1.00	1.47	na	199.1	-2.7	na	-1.4

*Inflation adjusted. †In $ terms. ‡Emerging Markets Free. §J.P. Morgan Chase's Emerging Markets Bond Index Plus.

Sources: National statistics offices, central banks and stock exchanges; Thomson Financial Datastream; Economist Intelligence Unit; Reuters; Warburg Dillon Read; J.P Morgan Chase; Hong Kong Monetary Authority; Centre for Monitoring Indian Economy; FIEL; EFG-Hermes; Bank Leumi Le-Israel; Standard Bank Group; Garanti Bank; Deutsche Bank; Russian Economic Trends.

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